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Background Report on Unemployment Insurance Financing and Maine's Current Debt

Maine State Legislature

Office of Legislative Assistants

James A. McKenna III
Maine State Legislature

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STATE OF MAINE

ONE HUNDRED AND EIGHTH LEGISLATURE

COMMITTEE ON LABOR

January 2, 1979

BACKGROUND REPORT
ON UNEMPLOYMENT INSURANCE FINANCING
AND MAINE'S CURRENT DEBT

Prepared by
Joint Select Committee on Labor
108th Legislature

James A. McKenna, III
Office of Legislative
Assistants

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STATE OF MAINE
ONE HUNDRED AND EIGHTH LEGISLATURE
COMMITTEE ON LABOR

January 2, 1979

Representative John L. Martin
Chairman, Legislative Council

Dear Representative Martin:

Please find attached a background study on the current financing problems of the unemployment insurance fund. The Committee makes no recommendations at this time, preferring instead to allow the interested parties sufficient time to formulate possible solutions to the U.I. fund's indebtedness.

The report was prepared pursuant to House Paper 2180.

Sincerely,

Senator McNally
JAM
Senator Cecil H. McNally

Representative Bustin
JAM
Representative David W. Bustin

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B. Comments by Associated Industries of Maine on Unemployment Insurance Financing (December, 1978).

C. House Paper 2180, ordering the Committee on Labor to study unemployment insurance financing.

REPORT SUMMARY

1. Introduction (pages 1-2)

Because of a 1975-76 recession, Maine has borrowed $36.4 million from the Federal government in order to keep its Unemployment Insurance (U.I.) fund solvent. If this debt is not paid back, Maine employers will be penalized by a higher Federal U.I. tax rate. To repay this debt and insure future U.I. fund solvency may well require a change in the way the U.I. fund is financed. The question to be answered: what is the minimal change sufficient to return the U.I. fund to a solvent condition?

2. Description of the current employers' tax for unemployment insurance (pages 2-5)

The employers' U.I. tax is part Federal and part State. The entire Federal tax is not levied if the State's U.I. program meets Federal requirements. This is how the Federal government insures compliance with its regulations. For example, if Maine fails to repay its Federal loan, the Federal tax will be increased.

3. Maine's repayment of loans made under the Federal Unemployment Tax Act (FUTA) (pages 5 to 9)

It is likely Maine will be granted a deferral of its $34.6 million loan for 1979; but repayment would then be scheduled for Nov. 10, 1980. If Maine fails to make this repayment date then Maine employers would be assessed additional Federal taxes equal to $32 million from 1980 through 1982.

4. Major funding options (pages 9 to 16)

Major funding options represent financing changes which could produce sufficient revenues to both pay off the Federal debt and improve the solvency of the U.I. fund. The Department of Manpower Affairs feels the following three options could be profitably studied:

A. Flexible taxable wage base: the wage base (currently $6,000) against which the U.I. tax is levied would increase if average U.I. tax covered wages increased. By November 10,1980, when the $36.4 million debt could be due, this reform would produce a fund surplus of $6.2 million (not counting the borrowed $36.4 million).

B. Increased tax rates: the average employer's U.I. tax would jump from 3.3% in 1978 to 4.0% in 1982. By November 10, 1980, when the Federal debt is due, this reform would have produced a surplus of $34.1 million (not counting the borrowed money).

C. Combination of flexible tax base and increased rates: by 1980 a surplus of $40.7 million would be created (not counting the borrowed money).

Of these three options only the combination of the flexible tax base and increased rates would clearly seem to satisfy the Federal requirement that the U.I. fund have reserves sufficient for 6 months after paying its Federal debt.

5. Minor funding options (pages 17 to 24)

Minor funding options include financing changes which might produce less revenues than the "major" options:

A. Employee contributions: if the Alaska employee tax rate were adopted in Maine, perhaps $10 million more a year would be raised.

B. Employer solvency tax: an additional tax assessed if fund reserves are too low. If the Arkansas version were adopted in Maine the additional revenues might be $3.8 million a year.

C. Surtax on negative balance employers: an additional tax on employers with poor record of employee lay-offs. This proposal might increase yearly revenues by $1.3 million.

D. Extended benefit employer tax: an additional employer tax if extended benefits are triggered. This also might produce an additional $1.3 million each year.

E. General Fund revenues: diverting State General Fund revenues to the U.I. fund.

F. Limit U.I. qualifications and benefits: reduce the employers' tax burden by reducing U.I. benefit costs.

6. Fund adequacy standards: how great should the U.I. fund reserves be? (pages 24 to 27)

The Federal government recommends that U.I. fund reserves should meet its 1 1/2 multiple standard: 1 1/2 years of recessionary level benefits. In Maine the Department calculates this will mean by 1982 a surplus of $174 million. If no financing changes are made in our current system Maine might have a $2.8 million deficit by 1982.

7. Analysis of the Associated Industries of Maine's response to Maine's Federal debt. (pages 28 to 32)

A.I.M. feels there is no immediate need to consider changing the financing of the U.I. fund. If reform is needed, the reduction of benefits and the narrowing of eligibility should be investigated.

It is possible, however, legislation will be needed before the end of the First Regular Session in 1979.

8. Conclusion (page 33)

If legislation effective January 1, 1980 is needed, a study group should begin work immediately.

1. INTRODUCTION

Because of a recession that reached greatest severity in 1975 (8.2% insured unemployment rate), Maine has borrowed $36.4 million from the Federal government under the Federal Unemployment Tax Act (FUTA). If a 1979 deferral of this debt is not granted by the Federal government, Maine employees' FUTA tax rates will be increased. Repayment of this Federal debt can be achieved by a change in the way the Unemployment Insurance (UI) Fund is financed. This report discusses this problem and suggests a list of both major and minor financing options. Major financing options would be those of such significant impact as to offer solutions to the Fund's outstanding Federal debt and possible future deficit. Minor financing options would be those that might improve the equity and efficiency of the system but which might not be significant enough to erase the fund's debt or insure its solvency in future years.

At basic issue is: how small an increase in the employer's U.I. tax burden would be sufficient to pay our Federal debt? The many possible answers to this question range from major changes in the method of financing the U.I. fund, to reduction in unemployment benefits, to no action at all.

If the U.I. fund had never borrowed from the Federal government, the current tax system would likely insure a deficit balance for the foreseeable future. Assuming a 4.8% insured unemployment rate (*see* Footnote No. 4):

Year	Benefits Paid	Con. Received	Fund Balance
1978	$43.9M	$51.1M	(-) $13.2M *
1979	48.4	55.9	(-) 5.7
1980	53.1	57.9	(-) 0.9
1981	58.3	59.6	0.4
1982	64.8	60.8	(-) 2.8

* does not include borrowed Federal funds

2. DESCRIPTION OF THE CURRENT EMPLOYER'S TAX FOR UNEMPLOYMENT INSURANCE

A. Introduction. Before discussing the specifics of Maine's U.I. indebtedness and its possible solutions, it is important to understand the current U.I. funding mechanism.

Each Maine employer covered [1/] by Maine's employment security

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1/ The following employers are covered under the Maine Employment Security law:

A. Private: employ 1 or more workers in at least 20 weeks or pay wages of $1,500 during any calendar quarter;

B. Agricultural: employ at least 10 workers in 20 weeks or pay at least $20,000 in any calendar quarter;

C. Nonprofit: employers who employ 4 or more workers in 20 weeks;

D. Domestic: any employer who pays wages of at least $1,000 in any calendar quarter; and

E. State and local government: all employees of State and local government except for:

(1) Elected officials;
(2) Legislature and judiciary;
(3) National Guard;
(4) Emergency employees, and
(5) Inmates.

law pays a tax on the first $6,000 of each employee's wages (the taxable wage base). The revenues of this tax fund the U.I. program. This tax is part federal tax and part state tax.

B. Federal part of the employers' tax. The Federal Unemployment Tax Act (FUTA) established a two part employer's tax: The FUTA tax and a state tax. The FUTA tax was designed to both fund federal U.I. costs and to encourage states to adhere to federal guidelines. Part of the federal tax is not levied if the State's U.I. program meets federal requirements. The threat of a higher federal tax is the "inducement" the Federal government uses to make states meet their regulations. For example, if Maine fails to pay back its federal loan, its FUTA tax rate will be increased. Specifically:

(1) The total FUTA tax is 3.4% of the taxable wage base;

(2) A credit of 2.7% is allowed to employers who pay state taxes under a federally approved U.I. program;

(3) The federal portion of the tax is 0.7%.[2/]

Thus, the employer's actual tax rate is 0.7% (the FUTA share) added to the employer's experienced-rated state tax.

2/ 0.7% of FUTA tax is to:

A. Pay all administrative costs, both State and Federal, of operating the unemployment compensation and job service programs;

B. Pay 50% of cost of extended benefit program;

C. Pay 100% of cost of Federal supplemental benefit program; and

D. Maintain loan fund from which states may borrow.

C. State part of the employer's tax. Each employer's state tax is determined by the state's taxable wage base (currently set at $6,000), his experience rating (has he laid off many U.I. eligible workers?) and the amount of reserves present in the U.I. fund (if reserves are low, the employer's tax increases). Briefly:

The Employer Reserve Ratio indicates an employer's experience rating: if his employment is stable he is eligible for reduced rates. For each employer, benefits paid to his laid-off workers are subtracted from his U.I. contributions and divided by the employer's 3 year average annual taxable payroll.

The Reserve Multiple sets forth 16 columns. Each of these columns from A to P represent a measure of aggregate unemployment reserve funds. As funds fall below a desired fund range, employer tax rates are increased. Currently, because the fund has a deficit balance, employers are charged the maximum rate, column P. As the fund's balance increases, the reserve multiple tax rate will decrease. The Reserve Multiple reflects economic activity because it incorporates the average cost rate over the last 15 years, the U.I. fund balance as of May 31, and the total payroll of taxable employers.

19.0% reflects an employer with few layoffs and few unemployment benefits charged against his account. His tax rate is the lowest (see Column P). Employers as either "rated", (those with 2 or more years of experience) or "non-rated" (assigned the average tax rate, but not more than 3 %).

Negative Balance represents the other extreme: an employer with many layoffs, whose former employees draw more benefits than the employer contributed in taxes (e.g., a seasonal employer). His tax rate, at 5.0%, is the highest (see Column P).

HOW TO DETERMINE AN EMPLOYER'S RATE

The EXCESS is the TOTAL CONTRIBUTIONS credited less TOTAL BENEFITS charged. The RESERVE RATIO is the EXCESS DIVIDED by the AVERAGE ANNUAL TAXABLE PAYROLL for 1975, 1976, and 1977.

EMPLOYER'S CONTRIBUTION RATE IN PERCENT OF WAGES

Reserve Ratio		When Reserve Multiple is: over 2.50	2.37-2.50	2.23-2.36	2.09-2.22	1.95-2.08	1.81-1.94	1.67-1.80	1.53-1.66	1.39-1.52	1.25-1.38	1.11-1.24	.97-1.10	.83-.96	.68-.82	.45-.67	under .45
Equal to or more than	Less than Column A	SCHEDULES A	B	C	D	E	F	G	H	I	J	K	L	M	N	O	* P
19.0% and over		0.5%	0.6%	0.7%	0.8%	0.9%	1.0%	1.1%	1.2%	1.3%	1.4%	1.5%	1.6%	1.7%	1.8%	1.9%	2.4%
18.0%	19.0%	0.6%	0.7%	0.8%	0.9%	1.0%	1.1%	1.2%	1.3%	1.4%	1.5%	1.6%	1.7%	1.8%	1.9%	2.0%	2.5%
17.0%	18.0%	0.7%	0.8%	0.9%	1.0%	1.1%	1.2%	1.3%	1.4%	1.5%	1.6%	1.7%	1.8%	1.9%	2.0%	2.1%	2.6%
16.0%	17.0%	0.8%	0.9%	1.0%	1.1%	1.2%	1.3%	1.4%	1.5%	1.6%	1.7%	1.8%	1.9%	2.0%	2.1%	2.2%	2.7%
15.0%	16.0%	0.9%	1.0%	1.1%	1.2%	1.3%	1.4%	1.5%	1.6%	1.7%	1.8%	1.9%	2.0%	2.1%	2.2%	2.3%	2.8%
14.0%	15.0%	1.0%	1.1%	1.2%	1.3%	1.4%	1.5%	1.6%	1.7%	1.8%	1.9%	2.0%	2.1%	2.2%	2.3%	2.4%	2.9%
13.0%	14.0%	1.1%	1.2%	1.3%	1.4%	1.5%	1.6%	1.7%	1.8%	1.9%	2.0%	2.1%	2.2%	2.3%	2.4%	2.5%	3.0%
12.0%	13.0%	1.2%	1.3%	1.4%	1.5%	1.6%	1.7%	1.8%	1.9%	2.0%	2.1%	2.2%	2.3%	2.4%	2.5%	2.6%	3.1%
11.0%	12.0%	1.3%	1.4%	1.5%	1.6%	1.7%	1.8%	1.9%	2.0%	2.1%	2.2%	2.3%	2.4%	2.5%	2.6%	2.7%	3.2%
10.0%	11.0%	1.4%	1.5%	1.6%	1.7%	1.8%	1.9%	2.0%	2.1%	2.2%	2.3%	2.4%	2.5%	2.6%	2.7%	2.8%	3.3%
9.0%	10.0%	1.5%	1.6%	1.7%	1.8%	1.9%	2.0%	2.1%	2.2%	2.3%	2.4%	2.5%	2.6%	2.7%	2.8%	2.9%	3.4%
8.0%	9.0%	1.6%	1.7%	1.8%	1.9%	2.0%	2.1%	2.2%	2.3%	2.4%	2.5%	2.6%	2.7%	2.8%	2.9%	3.0%	3.5%
7.0%	8.0%	1.7%	1.8%	1.9%	2.0%	2.1%	2.2%	2.3%	2.4%	2.5%	2.6%	2.7%	2.8%	2.9%	3.0%	3.1%	3.6%
6.0%	7.0%	1.8%	1.9%	2.0%	2.1%	2.2%	2.3%	2.4%	2.5%	2.6%	2.7%	2.8%	2.9%	3.0%	3.1%	3.2%	3.7%
5.0%	6.0%	1.9%	2.0%	2.1%	2.2%	2.3%	2.4%	2.5%	2.6%	2.7%	2.8%	2.9%	3.0%	3.1%	3.2%	3.3%	3.8%
4.0%	5.0%	2.0%	2.1%	2.2%	2.3%	2.4%	2.5%	2.6%	2.7%	2.8%	2.9%	3.0%	3.1%	3.2%	3.3%	3.4%	3.9%
3.0%	4.0%	2.2%	2.3%	2.4%	2.5%	2.6%	2.7%	2.8%	2.9%	3.0%	3.1%	3.2%	3.3%	3.4%	3.5%	3.6%	4.1%
2.0%	3.0%	2.4%	2.5%	2.6%	2.7%	2.8%	2.9%	3.0%	3.1%	3.2%	3.3%	3.4%	3.5%	3.6%	3.7%	3.8%	4.3%
1.0%	2.0%	2.6%	2.7%	2.8%	2.9%	3.0%	3.1%	3.2%	3.3%	3.4%	3.5%	3.6%	3.7%	3.8%	3.9%	4.0%	4.5%
.0%	1.0%	2.8%	2.9%	3.0%	3.1%	3.2%	3.3%	3.4%	3.5%	3.6%	3.7%	3.8%	3.9%	4.0%	4.1%	4.2%	4.7%
Negative balance		3.1%	3.2%	3.3%	3.4%	3.5%	3.6%	3.7%	3.8%	3.9%	4.0%	4.1%	4.2%	4.3%	4.4%	4.5%	5.0%

*The Rates in Column "P" are effective July 1, 1978, as the Reserve Multiple on May 31, 1978, was minus .30.

Thus, the employer's total tax rate is a combination of the Federal FUTA tax and the State tax:

For example: if employer's experience rated state tax is 2.4% (see Column P in tax schedule, an employer with an excellent experience rating), his total tax is:

2.4% state tax
0.7% FUTA tax
3.1% total tax rate applied against the first $6,000 of employee's salary.

3. MAINE'S REPAYMENT OF LOANS MADE UNDER THE FEDERAL UNEMPLOYMENT TAX ACT (FUTA)

A. Introduction. Maine first borrowed U.I. funds from the Federal government in September 1975, and to date the State has obtained $36.4 million in loans. The Department of Manpower Affairs described to the Committee the FUTA loan collection mechanism:

> Under normal conditions, states must repay all loans received by November 10 of the second year following the loan in order to avoid any FUTA penalty taxes. Since Maine borrowed in 1975, the State was potentially liable for FUTA penalty taxes for 1977 unless all loans were repaid by November 10, 1977. Public laws 94-45 and 95-19 amended the FUTA collection procedures and enabled the states to defer the repayment due dates on a year-by-year basis for taxable years 1977, 1978, and 1979, if certain conditions were met. Maine qualified for a deferral in 1977 and thus avoided any penalty assessments. A deferral has been requested for 1978 and it appears that Maine will meet the requirements in 1978. However, it is questionable whether or not Maine will qualify for a deferral in 1979 unless legislation is enacted to increase employer contributions. Maine has been qualifying for a deferral by enacting legislation to raise the average employer tax rate such that it exceeded the annual benefit cost rate 3/ for the 10 immediately preceding years. To qualify for previous deferrals, the employer tax rate was increased by 0.3 percent for 1977 and, beginning in 1978, the taxable wage base was increased to $6,000. With regard to a deferral for 1979, it is uncertain as to whether Maine would qualify if the level of unemployment is above average.

3/ The benefit cost rate is figured by dividing the total benefits paid out of the U.I. fund in any year by the total wages paid by employers. For example, 1975 had the highest benefit cost rate since 1958: $\frac{58,330,903}{2,055,161,391} = 2.84\%$

If a deferral for 1979 is not granted, the FUTA collection procedures would be invoked. All loans would have to be repaid by November 10, 1979 or Maine employers would have their FUTA credits reduced by 0.3 percent for 1979. The reduction in FUTA credits would be increased for each year that there is an outstanding balance. To provide an indication of the effects of these FUTA credit reductions, the following tables were developed based on the assumption that the insured unemployment rate will be 4.8 percent for 1978 and each year through 1982. 4/

Projected Amounts Payable Under FUTA by Maine Employers Without a Deferral for 1979

Taxable Year	Taxable Wages	Penalty FUTA Tax	Amount Due*
1979......................	$1,703,800,000	0.3%	$ 5,100,000
1980......................	1,764,800,000	0.6	10,600,000
1981......................	1,813,900,000	0.9	16,300,000
1982......................	1,846,700,000	1.2	22,200,000

4/ The "uninsured" employment rate does not represent all Maine persons out of work, only those eligible for U.I. benefits.

All Department projections in this report are based on the assumption that the insured unemployment rate will be 4.8 percent for 1978 and each year through 1982. The 4.8 percent is considered a moderate rate and was determined by taking the average of the insured unemployment rates for the past 10 years from 1967-1976. During this period, the insured unemployment rate has varied from a low of 2.6 percent in 1967 to a high of 8.2 percent in 1975. The Department stresses that no degree of probability should be attached to this assumption. It is not a Department forecast. The average rates for the last 10 years are:

Year	Insured Unemployment Rate
1967	2.6%
1968	2.9%
1969	3.6%
1970	4.7%
1971	6.7%
1972	4.6%
1973	3.9%
1974	5.0%
1975	8.2%
1976	6.0%
1977	5.9%

Projected Amounts Payable Under FUTA by Maine Employers With a Deferral for 1979

Taxable Year	Taxable Wages	Penalty FUTA Tax	Amount Due*
1980......................	$1,764,800,000	0.3%	$ 5,300,000
1981......................	1,813,900,000	0.6	10,900,000
1982......................	1,846,700,000	0.9	16,600,000

* FUTA payments are due by January 31 of the following year, e.g., the 1980 amount is due by January 31, 1981.

B. State failure to qualify for a deferral. If we were to assume that the State does not qualify for a deferral in 1979 and that no tax modifications are made to increase U.I. fund revenues, then the Department, again assuming a 4.8% insured unemployment rate,[5/] calculates that Maine employers, not the State, would

5/ The Department of Manpower Affairs presented the Committee with the following additional details on the effects of not receiving a 1979 deferral:

Projected FUTA Tax Rates If No Deferral Is Granted for 1979

Taxable Year	Balance Due January 1	Balance Due November 10	Basic Federal Tax	Federal Penalty Tax	Additional Federal Penalty Tax	Total Federal Tax	Average State Tax	Average Total State and Federal Tax
1975......	no	yes	0.5%	0.0%	0.0%	0.5%	2.8%	3.3%
1976......	(yes)*	(yes)*	0.5	0.0	0.0	0.5	3.2	3.7
1977......	(yes)*	(yes)*	0.7	0.0	0.0	0.7	3.6	4.3
1978......(1)	(yes)*	(yes)*	0.7	0.0	0.0	0.7	3.3	4.0
1979......(2)	yes	yes	0.7	0.3	0.0	1.0	3.3	4.3
1980......(3)	yes	yes	0.7	0.6	0.0 1/	1.3	3.3	4.6
1981......(4)	yes	yes	0.7	0.9	0.0 1/	1.6	3.3	4.9
1982......(5)	yes	yes	0.7	1.2	0.0 2/	1.9	3.3	5.2

Note: The above data were developed based on the assumption that a deferral for 1979 is not granted and that the insured unemployment rate will be 4.8 percent for 1978 and each year through 1982.

* Since a loan was first obtained in 1975, the State was potentially liable for repayment by November 10, 1977 However, a deferral was granted for 1977 which postponed the repayment due date to November 10, 1978. It is assumed that a deferral will be granted for 1978 and that the loan repayment due date will be delayed to November 10, 1979.

1/ The State may be liable for an Additional Federal Penalty Tax for the third and fourth taxable years. This is determined by subtracting the average employer contribution rate for the preceding year from 2.7 percent. The remainder is the Additional Federal Penalty Tax. Since the average employer contribution rate is projected to be 3.3 percent, no Additional Federal Penalty Tax would be assessed in 1980 and 1981.

2/ The Additional Federal Penalty Tax for the fifth and succeeding taxable years is determined in the following manner: If the five-year benefit cost rate is 2.7 percent or less, subtract it from the average employer contribution rate for the preceding calendar year. If the five-year benefit cost rate is greater than 2.7 percent, subtract the average contribution rate from 2.7 percent. The remainder is the Additional Federal Penalty Tax. Since both the five-year benefit cost rate for 1982 and the average contribution rate are projected to be above 2.7 percent, no Additional Federal Penalty tax would be assessed in 1982.

$$\text{Five-Year Benefit Cost Rate for 1982} = \frac{\text{Benefits Paid in Years 1976-1980 Divided by Five}}{\text{Taxable Wages for 1981}}$$

$$= \frac{\$50,093,137}{\$1,813,900,000}$$

$$= 2.76\%$$

be assessed additional FUTA payments to the Federal government of $32 million for the 1979-81 period. The Department calculates that a balance of $4.4 million would still be due which could be repaid from the State's Fund prior to November 10, 1982 and thereby avoid FUTA loan charges for 1982. The year-end Fund balance for 1982 after all loans were repaid would be $29.2 million:

Loan Repayment Schedule Under Existing Financing System Without a Deferral for 1979
(All Financial Data in Thousands)

Year	Fund Balance (Year-End) Excluding Loans	Fund Balance (Year-End) Including Loans	FUTA Payments During Year	Repayments Made From Fund	Outstanding Loans
1978....	(-)$13,200	$23,200	$ 0	$ 0	$36,400
1979....	(-) 5,700	30,700	0	0	36,400
1980....	4,200	35,500	5,100	0	31,300
1981....	16,100	36,800	10,600	0	20,700
1982....	29,200	29,200	16,300	4,400	0
			$32,000 (increased FUTA payments are considered part of U.I. balance)		

In order to see more clearly the effect on employers of the federal government were to deny deferral in 1979 and the loans remained unpaid, consider the following example:

An employer of 20 persons and a record of few lay-offs, with an experience-rated state tax of 2.5% (see chart on page 4). In 1979 his taxable wage base would be $120,000 (6,000 X 20 persons). His federal tax would be increased by 0.3% penalty, which would mean an additional employer payment of $360. His total tax rate would be increased as follows if the loans are not paid off:

	1979	1980	1981	1982
State Tax	2.5%	2.5%	2.5%	2.5%
Federal Tax	1.0%*	1.3%	1.6%	1.9%
Total	3.5%	3.8%	4.1%	4.4%

(* 0.3% penalty added to 0.7% FUTA tax, see above, page 3).

C. Loan repayment schedule. As for the loan repayment schedule: if Maine should qualify for a deferral in 1979 (the last year that a state may qualify for a deferral under present Federal law), the total amount in Federal loans to the Unemployment Insurance Trust Fund would then become payable by November 10 of 1980. If the loan is not completely repaid by the November 10 deadline, FUTA collections will be due by January 31, 1981 on 1980 taxable wages. The Governor, upon recommendation of the Commissioner, Department of Manpower Affairs, initiates the repayments when a state can show that the remaining fund balance (after a payment is made) is still sufficient to meet benefit payments for the succeeding six months.

4. MAJOR FUNDING OPTIONS

A. Introduction. The Department of Manpower Affairs suggests[6/] that three major funding options could be considered as

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6/ Maine Department of Manpower Affairs (Employment Security Commission), Proposed Financing Modifications to the Maine Employment Security Law (April 1978).

possible solutions to the U.I. fund's $36.4 million debt to the federal government (see Appendix A for the Department's study). This report terms these options "major" as they could not only pay the federal debt but also increase the fund's surplus so that it could begin to approach the Federal "one and one half multiple" standard (funds sufficient to carry the fund through 1 1/2 years of recession). The three major options are:

(1) Flexible taxable wage base;

(2) Increased tax rates; and

(3) Combination of the flexible wage base and increased tax rates.[7/]

Of the three, the flexible taxable wage base is perhaps the most important. All Department projections are based on the assumption that the insured unemployment rate will be 4.8 percent for 1978 and each year through 1982 (see above Footnote No. 4).

B. Flexible taxable wage base. The Department described to the Committee the effect of a flexible taxable wage base. The wage base would depend on average wages and, therefore, would

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7/ The State qualified for deferral of the debt in 1977 by increasing the tax rate by 0.3% and in 1978 by increasing taxable wage base to $6,000.

change each year. During 1978 the taxable wage base would remain at $6,000.[8/] During 1979-1982 the base would increase as follows: 1979-$6,200; 1980-$6,600; 1981-$7,100; 1982-$7,200. The year end balances would rise steadily under this proposal and reach $25.4 million by 1982. The Department stated to the Committee:

> "The revised tax schedules generate large amounts of additional income during the first few years after enactment which results in improved Fund balances. These increases in the Fund balances will cause a more favorable tax schedule to become effective beginning July 1, 1981, thus reducing the employer tax rate."
>
> "Under the proposed flexible taxable wage base, the taxable wage base will continue to increase as wages increase and thereby keep the ratio of taxable wages relatively constant. This is important since benefit payments are based on total wages, whereas contributions received are related to taxable wages. It is actuarially unsound to levy taxes on a wage base that does not keep pace with rising total wages levels."

8/ An employer uses the wage base in calculating his tax in the following manner:

A. Payments are made by employers each quarter;

B. Payments are determined by: tax rate X taxable wages;

C. Payments are due at end of month following the close of the quarter January-March due April 30;

D. Penalties under Maine law are:

(1) 5% of contributions due but not less than $5 nor more than $100; and

(2) 1% per month of unpaid contributions;

E. For example, if employer's tax rate is 3.0% and taxable wage base is $6,000:

	Total Wages	Taxable Wages	Tax Rate	Contributions
1st quarter	$2,000	$2,000	3.0%	$ 60
2nd quarter	2,000	2,000	3.0%	60
3rd quarter	2,000	2,000	3.0%	60
4th quarter	2,000	0	3.0%	0
Total	$8,000	$6,000	3.0%	$180

Without a flexible wage base, an inflationary economy decreases the revenue producing capacity of the financing system and results in higher tax rates for employers.

This flexible taxable wage base would equal the larger of:

(1) 2/3 the average annual wage paid by covered employers during the 2nd preceding calendar year, rounded to the nearest $100; or

(2) the FUTA taxable wage base.

For example, the wage base for 1978 would be calculated:

Annual avg. wage paid during 2nd preceding year (1976)	=	$8,604
Multiplied by 2/3		X 2/3
Rounded to nearest $100	=	$5,736
	=	$5,700

Since the FUTA taxable wage base is higher, the base would be $6,000:

Year	Proposed Bases
1978	$6,000
1979	6,200
1980	6,600
1981	7,100
1982	7,600

If Maine adopted such a flexible wage base it would be one of 14 states with a wage base of $6,000 or more.[9/] Since 1940

9/ Other states with wage bases of $6,000 or more are:

Maine	$6,000
New Mexico	6,100
New Jersey	6,200
Iowa	6,500
Alabama	6,600
Nevada	6,900
Minnesota	7,500
Oregon	8,000
Washington	8,400
Idaho & Utah	9,600
Hawaii	9,800
Alaska	10,000
Puerto Rice	Total Wages

the taxable wage base has steadily decreased as a percentage of each employee's wage. In 1940, at $3,000, it represented over 90% of the average employee's wages. Today it represents less than 50%.10/

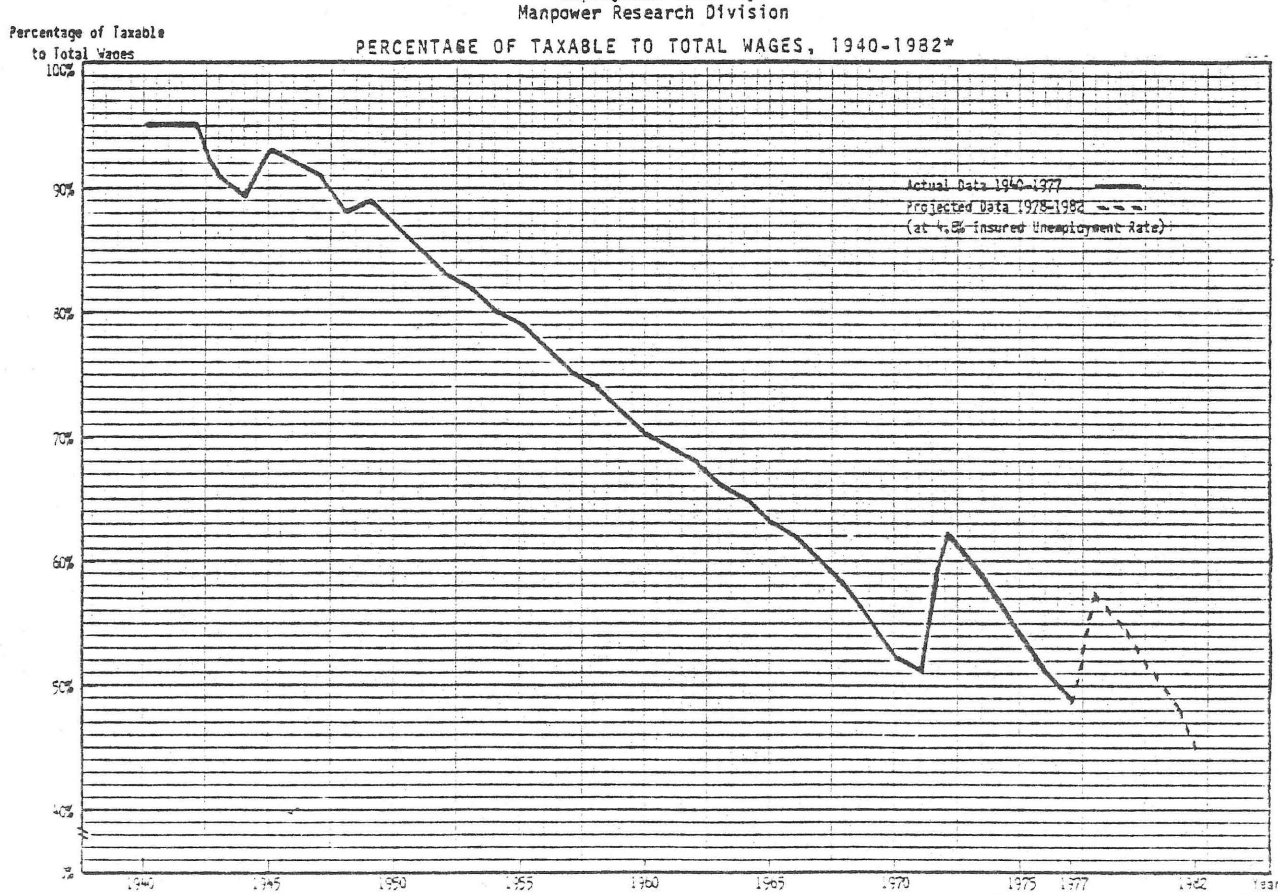
If Maine adopts a flexible taxable wage base the Department calculates its effect as follows:

> Projections for 1979 indicate that the State would qualify for a deferral if the proposed flexible taxable wage base is enacted to become effective at least by January 1, 1979. The State could delay implementation to 1979 since the taxable wage base would be $6,000 under both the existing and proposed systems. The projected repayment schedule under this option is as follows:

10/ The following chart was prepared by the Department's Employment Security Manpower Research Division:

MAINE DEPARTMENT OF MANPOWER AFFAIRS
Employment Security
Manpower Research Division

PERCENTAGE OF TAXABLE TO TOTAL WAGES, 1940-1982*



*In 1940, the taxable wage base was $3,000. The taxable wage base was increased to $4,200 in 1972 and to $6,000 in 1978. All data through 1977 is actual.

Loan Repayment Schedule Under Proposed Flexible
Taxable Wage Base With a Deferral for 1979
(All Financial Data in Thousands)

Year	Fund Balance (Year-End) Excluding Loans	Fund Balance (Year-End) Including Loans	FUTA Payments During Year	Repayments Made From Fund	Outstanding Loans
1978....	(-)$13,200	$23,200	$ 0	$ 0	$36,400
1979....	(-)2,600	33,800	0	0	36,400
1980....	6,200	42,600	0	0	36,400
1981....	20,900	20,900	5,300	31,100	0
1982....	30,700	30,700	0	0	0

Of the $36.4 million due, $5.3 million would be collected through FUTA and the remaining $31.1 million could be paid from the Fund by November 10 , 1981 and thus avoid any future FUTA credit reductions.

C. Increased current tax rates. The Department described to the Committee the effect of increasing the current tax rates. The average employer tax rate would jump from 3.3% in 1978 to 4.3% in 1979, and then taper off to 4.0% by 1982 (assuming 4.8% insured unemployment rate). The taxable wage base would continue to be $6,000. The fund balance would recover quickly under this condition and grow to $62.3 million by the end of 1982. If this option is adopted, the Department calculates:

If the proposed tax schedules are enacted with an effective date of July 1, 1978, it is believed that the State would qualify for a deferral in 1979. The following repayment schedule is projected:

Loan Repayment Schedule Under Proposed Tax
Schedules With a Deferral for 1979
(All Financial Data in Thousands)

Year	Fund Balance (Year-End) Excluding Loans	Fund Balance (Year-End) Including Loans	FUTA Payments During Year	Repayments Made From Fund	Outstanding Loans
1978....	(-)$12,900	$23,500	$ 0	$ 0	$36,400
1979....	11,600	48,000	0	0	36,400
1980....	34,100	34,100	0	36,400	0
1981....	52,600	52,600	0	0	0
1982....	62,300	62,300	0	0	0

Note that Maine employers would not be assessed any FUTA charges since complete repayment could be made from the Fund prior to November 10, 1980.

D. Combination: flexible taxable wage base and increased tax schedules. The Department also described to the Committee the result if options 1 and 2 were combined:

> Under this proposal, the taxable wage base would increase from $6,000 in 1978 to $7,600 in 1982. The average employer tax rate would move from 3.3 percent in 1978 to 4.3 percent in 1979 and 1980. After 1980 the average employer tax rate would drop as a result of increases in reserves. The Fund balance at the end of each year would be the greatest under this proposal and reach $93.9 million by the end of 1982.
>
> Since the taxable wage base for 1978 would be the same under both the current and proposed system, only the proposed tax schedules aspect need be effective July 1, 1978 for the State to qualify for a deferral in 1979. Below is the projected repayment schedule under this option:

Loan Repayment Schedule Under the Proposed Tax Schedules and Flexible Taxable Wage Base With a Deferral for 1979
(All Financial Data in Thousands)

Year	Fund Balance (Year-End) Excluding Loans	Fund Balance (Year-End) Including Loans	FUTA Payments During Year	Repayments Made From Fund	Outstanding Loans
1978....	(-)$12,900	$23,500	$ 0	$ 0	$36,400
1979....	13,100	49,500	0	0	36,400
1980....	40,700	40,700	0	36,400	0
1981....	69,600	69,600	0	0	0
1982....	93,900	93,900	0	0	0

> As with the proposed tax schedules, complete repayment could be made by November 10, 1980 from the Fund and no FUTA assessments would be necessary. The Fund balance of $93.9 million at the end of the period in 1982 would be the highest of all four options.
>
> In regards to the development of an acceptable multiple, the above option comes closest to meeting the minimum safety level prescribed by the U.S. Department of Labor. The 1982 multiple under this option is projected to be .81 which is below the 1.50 federal safety level. (See Section 6 of this memo for a discussion of the proper U.I. fund surplus). Although no projections have been made beyond 1982, it is believed that under this option a multiple of 1.50 would be attained by approximately 1988.

E. Summary of major funding options. The Department has prepared the following summary chart of the three major funding options:

Projected December 31 Fund Balance Under Each Proposal
1978-1982

Year	Current Law	Proposed Tax Schedule	Proposed Flexible Taxable Wage Base	Proposed Tax Schedules and Flexible Taxable Wage Base	Acceptable Fund Level
1978..........	$(-)13,200,000	$(-)12,900,000	$(-)13,200,000	$(-)12,900,000	$121,700,000
1979..........	(-) 5,700,000	11,600,000	(-) 2,600,000	13,100,000	133,100,000
1980..........	(-) 900,000	34,100,000	6,200,000	40,700,000	145,600,000
1981..........	400,000	52,600,000	15,600,000	69,600,000	159,200,000
1982..........	(-) 2,800,000	62,300,000	25,400,000	93,900,000	174,000,000

NOTE: All estimates are based on the assumption that the insured unemployment rate will be 4.8 percent for each year of the 1978-1982 period. The actual Fund balance at the end of each year would be higher by the amount of loans outstanding at that period.

Please note that the final column in the above chart, Acceptable Fund Level, refers to the Federal 1 1/2 multiple standard (each U.I. fund should have reserves sufficient to last through 1 1/2 years of a recession). Whether this is too high a standard is discussed in Section 6 of this Report.

Finally, of these three major options only the combination of a flexible taxable wage base and the increased tax rate would clearly satisfy the federal requirement that the U.I. fund have sufficient reserves for 6 months after paying its Federal debt (see Section 7 of this Report).

5. MINOR FUNDING OPTIONS

A. Introduction. The funding options discussed in this section are termed "minor" only because their expected revenues would seem to be somewhat less than the "major" funding options. Again, the dilemma that must be faced is: how small an increase in employers' taxes is needed for Maine to pay-off its Federal debt and provide the U.I. fund with sufficient reserves. It may very well be that one of these "minor" options is sufficient.

B. Employee contributions. A few states, Alabama, Alaska, and New Jersey levy a U.I. tax on employee wages:

State	% of employee tax	taxable wage base
Alabama	0.5	$ 6,600
Alaska	0.3 to 0.8	$10,000
New Jersey	0.5	$ 6,200

Alabama levies the tax only when the fund is below a minimum normal level.

The effect of a tax such as Alaska's in Maine was calculated for the Committee by the Department of Manpower Affairs:

"Alaska requires employee contributions on a yearly basis up to the taxable wage base of $10,000 at rates varying from 0.3 to 0.8 percent depending upon the schedule of rates in effect. Alaska's rate schedules are determined by a reserve multiple which is similar in design to Maine's system."

Alaska Employee Tax Schedules

IF THE RESERVE MULTIPLE OF THE FUND IS:

	Over 3.3	2.0-3.0	1.5-2.0	1.35-1.5	1.15-1.35	1.0-1.15	.85-1.0	.67-.85	.33-.67	Under .33
Employee Tax Rates Per Schedule....	0.3%	0.4%	0.5%	0.5%	0.6%	0.6%	0.7%	0.7%	0.8%	0.8%

"The taxable wage base in Maine was $4,200 which generated taxable wages of $1,251,592,763 during 1977. If the Alaska Employee Tax Schedules listed above were effective during 1977 in Maine, an employee tax of 0.8 percent would have been assessed. The estimated 1977 employee contributions due under this option would have been as follows:

Employee Contributions Due = (Taxable Wages) (Employee Tax)
for 1977 = ($1,251,592,763) (0.8%)
= $10,000,000

Donald Diefenback in his 1978 study, Financing America's Unemployment Compensation Program,[11/] feels an employee tax should be investigated and noted the following arguments for or against an employee (U.I.) tax:

(1) Argument for. A worker tax could provide an employer general tax relief.

(2) Argument against. A worker tax would lead to a tendancy to relax disqualification regulations.

11/ Diefenbach, D.L., Financing America's Unemployment Compensation Program, U.S. Department of Labor, Employment and Training Administration (1978).

C. Employer solvency tax. An employer solvency tax is a tax that is assessed in addition to regular taxes when fund reserves drop below certain predetermined levels. Arkansas has an employer solvency tax which depends upon the fund level as a percent of total payrolls for the preceding year and operates as follows:

(1) a 0.1 percent tax is assessed when the fund level drops below 2.5 percent but is at least 1.25 percent of total payrolls,

(2) a 0.2 percent tax when the fund is less than 1.25 percent but greater than 0.0 percent, and

(3) a 0.3 percent tax when the fund is insolvent.

If the Arkansas employer solvency tax provisions described above were effective in Maine during 1977, the following estimated additional contributions would have been due:

Employer Solvency Tax Contributions Due for 1977	= (Taxable Wages)(Solvency Tax)
	= (\$1,251,592,763)(0.3%)
	= \$3,800,000

Some other states with such a tax are Nevada, Illinois and Missouri.

D. Surtax on negative balance employers. Last session L.D. 2039 was introduced to impose a surtax on negative-balance employers (an employer with many lay-offs, whose former employees draw more benefits than their employer contributed in U.I. taxes). This surtax would have varied according to the size of the negative reserve ratio. The Department made the following fiscal estimates:

The following estimates are provided had the proposal been effective during calendar year 1975:

Estimated contributions due from negative-balance employers under the proposed law $8,600,000

Estimated contributions due from negative-balance employers under the present law $7,300,000

Estimated amount of additional contributions from negative-balance employers $1,300,000
Percent increase 17.8

The proposed schedule was:

If, on the most recent computation date, the employer's reserve ratio is negative by:	The employer's surtax rate shall be:
Less than 0.9%	0.0%
0.9% or more, but less than 1.8%	0.3%
1.8% or more, but less than 2.8%	0.6%
2.8% or more, but less than 3.7%	0.9%
3.7% or more, but less than 4.6%	1.2%
4.6% or more, but less than 5.6%	1.5%
5.6% or more, but less than 6.6%	1.8%
6.6% or more, but less than 7.5%	2.1%
7.5% or more, but less than 8.5%	2.4%
8.5% or more, but less than 9.5%	2.7%
9.5% or more	**3.0%**

This negative balance surtax is a variation of other mechanisms (e.g., a "limited liability" tax, a "continuous rating" tax) designed to single out employers who consistently generate extraordinarily high levels of unemployment. Donald Diefenback in his 1977 Survey of Unemployment Insurance Financing Issues,[12/] lists some arguments for the "limited liability" approach:

12/ Diefenbach, D.L., Survey of Unemployment Insurance Financing Issues, New Jersey Department of Labor and Industry (1977).

"The unemployment insurance program is insured against the risk of involuntary unemployment. Generally, individuals employed in seasonal industries are exposed to a higher than average risk of unemployment. Such workers receive a proportionately greater share of unemployment benefits than do workers employed in nonseasonal industries. Consistent with insurance principles, employer contribution rates are experience rated to reflect various degrees of risk as evidenced by previous experience with unemployment. Employers generating the greatest rates of unemployment are taxed at the maximum rate. In some instances, the employer's drain upon the fund far exceeds contribtions. To the extent that these excess costs reflect involuntary unemployment due to normal economic risks, such excess costs are justifiably borne by other employers. The extent to which such excess costs are systematically used to supplement the employer's payroll, i.e., to hold workforce intact until next production cycle, it is questionable whether such excess costs ought to be borne by other employers."

E. Extended benefit employer tax. Extended benefits[13/] are "triggered" when the insured unemployment rate rises above certain levels. Regular benefits (up to 26 weeks) can then be extended by 50%, with the State and Federal government equally sharing the cost.

13/ "Extended benefits" refers to part Federally funded and part State funded programs to provide additional payments during periods of high unemployment when an individual is not entitled to or has exhausted regular benefits. "Extended benefits" total 13 weeks and become available when the State insured unemployment rate is above 5% and when the national insured unemployment rate is above 4.5%. In Maine, if these benefits were available a person could receive a total of 39 weeks of benefits.

An Extended Benefit (EB) account would defray the cost of EB payments. In Arkansas, each contributing employer must pay an additional EB tax of 0.1 percent of taxable wages. The EP tax is paid into an EB account but would be suspended if, on the computation date (June 30) of any year, the EB account is more than 0.2 percent of total payrolls during the preceding year.

If the Arkansas EB tax described above were effective in Maine during 1977, the Department estimates that the following additional contributions would have been due:

EB Employer Contributions Due=(Taxable Wages)(EB Tax)
for 1977 = ($1,251,592,763)(0.1%)
= $1,300,000

Since 1977 would be the first effective year of the EB tax, the EB account would have a zero balance. In Maine, the computation date is December 31, and the determination of EB taxes for the next year would be made as of that date.

F. General Fund revenues. The employers' tax burden might be reduced by using general fund revenues to finance part of the U.I. fund. Diefenbach in Financing America's Unemployment Compensation Program states:

> Historically, general revenues have been used to finance special federal U.I. programs - unemployment compensation for federal employees, unemployment compensation for ex-servicemen and trade adjustment assistance. Two recent legislative developments underscore the legitimacy and political feasibility of using general revenues for a much wider range of U.I. programs:
>
> (1) In 1975, the Special Unemployment Assistance Program (SUA) was implemented. This new program provided unemployment benefits to formerly uncovered workers (agricultural, domestic, and government workers); and

(2) Since April 1, 1975 Federal Supplemental Benefits (FSB) have been financed out of general revenues. Prior to this time FSB benefits had been financed by employer FUTA taxes.

The following categories of benefits are currently being debited as possible candidates for general revenue funding in the future:

(1) The federal share of extended benefits;

(2) The state share of extended benefits; and

(3) Abnormal U.I. costs related to an economic recession.

The issue of general revenue sharing financing is not one of legitimacy or political feasibility. These concerns have been resolved by legislative precedents of the 1970's. The issue today is one of cautiously defining what categories of benefits will be financed by general revenues in the future so as to preserve the federal-state makeup of the program and to avoid escalating costs which might result from indiscriminate tapping of this funding reservoir.

G. Limited U.I. qualification and reduced U.I. benefits. Another argument to reduce the employers' tax burden is that the U.I. fund's current deficit is in part due to the progressive escalation of benefits. Thus, one solution might be to either limit the number of workers who can qualify for U.I. benefits or to reduce the amount of benefits workers can receive.[14/] For example, in the 108th Legislature numerous bills proposed establishing more stringent eligibility requirements[15/] and recently Associated

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14/ Currently, Maine ranks 39th among the states as to its average weekly benefit amount, $73.68 (Department of Labor Unemployment Insurance Statistics, April-June, 1978). Portland is ranked 10th most expensive city in the county for a family of four (intermediate budget, Dept. of Labor, Bureau of Labor Statistics). Maine is ranked 42nd in the county as to per capita income (1975).

15/ E.g., L.D.s 290 and 385 sought to redefine when a unemployed person is "available" for work; L.D. 888 dealt with the definition or leaving work "for good cause"; L.D. 903 sought to redefine what was "suitable employment" and L.D. 143 considered when a person "voluntarily" left his job.

Industries of Maine suggested that serious consideration be given to the elimination of the increased benefits awarded if an unemployed person has dependents (see Section 7).16/

6. FUND ADEQUACY STANDARDS: HOW GREAT SHOULD THE U.I. FUND RESERVE BE?

A. Introduction. In the Department's study of major funding options (see Appendix A for a complete description) both a flexible taxable wage base was suggested and a higher tax schedule. The Department, in judging whether the U.I. fund reserves would be sufficient under these options, used as a measure the "one and one half multiple" standard recommended by the Federal government. Basically, this standard recommends that states should have one and a half years of recessionary level benefits stored in the U.I. fund. This guideline was originally derived from the observation

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16/ Of the 33 states with flexible maximum benefit provisions only Arkansas froze their benefit at the 1976 level of $100 for 1977-79. The maximum benefits in the 17 remaining states are usually determined by benefit schedules which are updated periodically. Of these 17 states, Alabama, Maryland, Michigan, and New York have outstanding Federal loans as of May 1978. In an effort to restore solvency, or to prevent insolvency, some states may be placing a moratorium on benefit increases.

that post World War II recessions approximated 18 months.

B. Adequate reserves and the Department's major funding options. The Department applied the Federal standard of a 1 1/2 multiple to the current law and these 3 major funding options:

(1) No change in the current rates (assumes a 4.8% insured unemployment rate):

Year	1 1/2 multiple Actual	1 1/2 multiple Acceptable	Fund Balance* (in millions) Actual	Fund Balance* (in millions) Acceptable
1978	(-).16	1.50	$(-)13.2	$121.7
1979	(-).06	1.50	(-) 5.7	133.1
1980	(-).01	1.50	(-) .9	145.6
1981	0	1.50	.4	159.2
1982	(-).02	1.50	(-) 2.8	174.0

* Does not reflect current outstanding debt of $23 million.

(2) Flexible taxable wage base (assumes 4.8% insured unemployment rate):

Year	1 1/2 multiple Actual	1 1/2 multiple Acceptable	Fund Balances* (in millions) Actual	Fund Balances* (in millions) Acceptable
1978	(-).16	1.50	$(-)13.2	$121.7
1979	(-).03	1.50	(-) 2.6	133.1
1980	.06	1.50	6.2	145.6
1981	.14	1.50	15.6	159.2
1982	.22	1.50	25.4	174.0

* Does not reflect $23 million outstanding debt.

(3) Increased tax schedule (assumes 4.8% insured unemployment rate):

Year	1 1/2 multiple Actual	1 1/2 multiple Acceptable	Fund Balances* (in millions) Actual	Fund Balances* (in millions) Acceptable
1978	(-).16	1.50	$(-)12.9	$121.7
1979	.13	1.50	11.6	133.1
1980	.35	1.50	34.1	145.6
1981	.50	1.50	52.6	159.2
1982	.54	1.50	62.3	174.0

* Does not reflect $23 million outstanding debt.

(4) Combined: flexible wage base and increased tax rate base

State	1 1/2 multiple Actual	1 1/2 multiple Acceptable	Fund Balances* (in millions) Actual	Fund Balances* (in millions) Acceptable
1978	(-).16	1.50	$(-)12.9	$121.7
1979	.15	1.50	13.1	133.1
1980	.42	1.50	40.7	145.6
1981	.65	1.50	69.6	159.2
1982	.81	1.50	93.9	174.0

* Does not reflect $23 million outstanding debt.

These Tables make clear that even if the State adopts the combined flexible wage base and increased tax rates, then the actual U.I. fund reserves would still fall considerably below (by $81 million) the "recommended" reserves.

C. Should Maine adopt a specific fund reserve standard?

How important is it to meet this "recommended" reserve level? Donald Diefenbach in Financing America's Unemployment Compensation Program (1978) recommends a reserve level lower than the Federal 1 1/2 multiple standard. For example, he estimates that while the Federal standard would indicate that

in 1978 Maine needs a reserve of $122 million, he would recommend only a $109 million reserve.

Further, Diefenbach notes that the issue of what is a proper reserve raises other possible factors:

(1) Deficit financing. Should the State seek to balance off periods of overfinancing and periods of underfinancing over the long run? The fund adequacy standard in a planned deficit financing system might be logically defined as "zero reserves".

(2) Countercyclical financing. Should lower than average tax rates be levied during periods of high unemployment and business recession? Conversely, should higher than average tax rates be levied during period of low unemployment and business expansion?

The question, then, is whether the committee wishes to recommend a specific fund adequacy standard and whether it should be different than the one recommended by the Federal government. Diefenbach comments:

> "The selection of a reserve criterion is important because it sets the tone for the development of a State revenue system for the long term future. Once a fund standard is selected and incorporated into the State law, it may remain inforce for decades, affecting individual firms, the State economy and the substance and image of the State unemployment insurance program."

7. ANALYSIS OF ASSOCIATED INDUSTRIES OF MAINE RESPONSE TO FEDERAL DEBT

A. Introduction. In response to a Committee request, Associated Industries of Maine made a detailed analysis of the U.I. funding problem. AIM's four main points would seem to be:

(1) It is AIM's opinion there "can be little doubt" that Maine will qualify for deferral of a loan obligation in 1979 and thereby avoid the penalty of an increased FUTA employer tax;

(2) that prospects for timely repayment of the $36.4 million loan by the November 10, 1980 appear "favorable";

(3) that there is, therefore, no immediate need to consider any of the major U.I. funding options set forth by the Department of Manpower Affairs; and

(4) that if the U.I. fund's present deficit position is in part due to the "progressive escalation of benefit levels," then serious consideration should be given to restricting eligibility and decreasing benefit amounts.

AIM's initial position on the U.I. funding problem is important and deserves further comment.

B. Maine will qualify for a 1979 loan deferral. Rather than agree wholeheartedly with AIM's "little doubt" that Maine will qualify for a 1979 deferral, the Department has taken a more cautious stance, stating that they wish to postpone any prediction, pending more recent information on the average employer tax rate for 1979 (which must be greater than the average cost rate of the 10 year period ending in 1978 in order to qualify for a deferral).

C. Prospects for timely repayment of the loan appear favorable. The Department does not appear as optomistic as AIM that Maine "will be able to repay the loan prior to the deadline of November 10, 1980 without incurring any penalties." AIM's contention is based on Department projections which show a November, 1980 U.I. fund balance of $44.6 million, more than enough to payoff the $36.4 million loan. However, the Department further projects by December 31, 1980 the U.I. balance will be down again to $37.4 million, leaving only a $1 million balance if the loan is paid off. Whether this $1 million balance is sufficient is problematical. Almost certainly the Fund again would have to quickly borrow from the Federal Government, as Fund payments during the winter and spring months normally exceed the revenues. In any case, the same projections of the Department reveal a $2.8 million deficit by 1982, so the problem of an under financed system will not disappear.

A development that adds to AIM's optimism is the possibility that Congress will pass legislation providing for reimbursement of states of their 50% share of extended benefit costs[17/] incurred from January 1, 1975 to January 1, 1978.[18/] If this were

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17/ See footnote No. 13.

18/ A 1978 interim legislative recommendation of the National Commission on Unemployment Compensation.

to happen it is estimated Maine would receive $15,000,000. But even these additional funds would not seem to meet the Federal 6 month fund reserves standard. Further, Congress might decide to forgive all or part of the U.I.debts owed to the Federal government by states.[19/]

D. No immediate need to consider changing U.I. fund financing. Certainly, AIM is correct in that an emergency bill is not

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19/ The National Commission on Unemployment Compensation recommended in 1978 not that the debt be forgiven but that another year of deferral be allowed if regulations were made more stringent. The indebted states as of May 1978 are:

States	LOAN BALANCE (Rounded to the nearest million)
Pennsylvania	$1,187
Illinois	946
New Jersey	735
Michigan	624
Connecticut	448
New York	366
Massachusetts	265
Minnesota	172
Washington	137
Rhode Island	102
Puerto Rice	89
District of Columbia	66
Maryland	63
Delaware	47
Vermont	46
Alabama	44
Maine	36
Arkansas	30
Hawaii	22
Montana	10
Total, All States	$5,435

necessary at this time. But some decisions need to be made relatively soon. If the option to increase tax rates were made effective January 1, 1980, the Department estimates a possible $17 million revenue increase, perhaps just barely enough to meet the November 10 deadline and to provide sufficient funds for the increase in benefits paid out in the winter and spring months. If both the flexible wage base and the increased tax rates were made effective January 1, 1980 increased revenues of perhaps $22 million surely would be a sufficient surplus to both pay the debt and keep the Fund from quickly reverting to a deficit state. The flexible wage base is especially desirable when the maximum benefit amount increases with increasing wage levels. A wage base that keeps pace with increasing wage levels automatically provides for increasing revenues to offset higher benefit amounts. This self-adjusting mechanism, however, may not be sufficient to restore the fund to acceptable standards when the fund has been allowed to become overdepleted as is presently the case.

E. <u>Benefits should be reduced and eligibility narrowed</u>. AIM's concern with lightening the employers' tax burden by decreasing the availability of unemployment insurance tends to divert attention from a significant flaw in the U.I. taxable wage base. Because the wage base is fixed at $6,000 the system's ability to generate needed revenues is continually eroded. Thus, more and more employers are being shunted toward the higher tax rates as their reserve ratios decline through experience rating. Over time, as the system's needs expand in response to ever present inflation, even self-supporting employers will tend to move down the rate schedule towards higher tax rates.[20]

20/ Having a wage base fixed at $6,000 would seem to discriminate against the small employer, as he is forced to pay a tax on a greater percentage of his total payroll than is a larger, higher paying employer.

F. AIM and the Department's differing emphasis.

AIM's emphasis on simply re-paying the debt and avoiding increased employer taxes is entirely proper, however it tends to obscure two very important considerations:

(1) All AIM calculations are based on the 4.8% insured unemployment rate, but this rate is a 10 year average, not a prediction. If a recession were to develop, certainly a possibility, the State's various options might change dramatically. Instead, the carefulness with which the 4.8% figure must be used is illustrated by the fact that the Department has just updated the average insured unemployment rate for the most recent 10 years and it is significantly higher than 4.8%. If AIM had used this new figure, then conclusions might have been different.

(2) Further, AIM's concern with avoiding an immediate employer's tax increase tends to obscure the Department's concern with a fund reserve that can withstand even a mild recession. In many ways the key question to be answered in U.I. funding is treated in section 6 of this study: Fund Adequacy Standards: How Great Should the U.I. Fund Reserve Be?

8. CONCLUSION

Surely, the U.I. funding problem needs immediate study. If financing changes are to become effective by January 1, 1980, legislation would have to be introduced prior to the end of the coming regular session. Compounding the problem is the fact that there is no guarantee that the assumed insured unemployment rate of

4.8% (an average of the past 10 years, not a forecast) will not in fact be higher than that. Currently, it appears slightly below that mark but during the recession of 1975 it rose to 8.2%. And a recession is at least possible in future years.

There are several possibilities as to who could conduct this study: a committee of small and large private employers, the Department, the Committee on Labor, a select committee made up of each of the above. Regardless of the study committee's composition it should be formed as soon as possible.

APPENDIX A: "PROPOSED FINANCING MODIFICATIONS TO THE MAINE EMPLOYMENT SECURITY LAW" by

Maine Department of Manpower Affairs, Manpower Research Division

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INTRODUCTION

The inadequacies of the Employment Security Law to finance benefits have been magnified as a result of the extremely high benefit costs of the last four years. The balance in the Unemployment Trust Fund at the end of 1977 was approximately $3 million with an outstanding debt of $22.9 million. Previous estimates have indicated that the Unemployment Trust Fund will remain in an unstable condition through 1982 depending upon the level of the unemployment rate. It is, therefore, important that alternatives be considered to strengthen the solvency position of the Fund.

This report addresses the effects of three possible legislative changes: (1) a revised set of tax schedules, (2) a flexible taxable wage base, and (3) a combination of revised tax schedules and a flexible wage base. These three provisions are examined separately for their estimated impact. It is assumed that the flexible taxable wage base became effective January 1, 1978, and the proposed tax schedules will become effective July 1, 1978. The final section of the report discusses what an adequate Fund level is and how this can be measured. A measure of the Fund is provided for each of the proposed legislative changes.

All projections in this report are based on the assumption that the insured unemployment rate will be 4.8 percent for 1978 and each year through 1982. The 4.8 percent is considered a moderate rate and was determined by taking the average of the insured unemployment rates for the past 10 years from 1967-1976. During this period, the insured unemployment rate has varied from a low of 2.6 percent in 1967 to a high of 8.2 percent in 1975. In recent years, the following insured unemployment rates have been experienced: 1974--5.0 percent, 1975--8.2 percent, 1976--6.0 percent, and 1977--6.0 percent (estimated).

For purposes of showing the true condition of the Fund, this report excludes money borrowed from the Federal government. In so doing, negative balances will occur; however, in actuality the Fund will never be allowed to drop to a negative level. As of December 31, 1977, a total of $22.9 million in Federal loans had been obtained. If this $22.9 million in Federal loans were included, the projected Fund balances for the end of each year in this study would increase by that $22.9 million. For example, the projected 1982 Fund balance including Federal loans received as of February 1, 1978, would be $20.1 million under the current law; $85.2 million under the proposed tax schedules, $48.3 million under the proposed flexible taxable wage base, and $116.8 million under the proposed tax schedules and flexible taxable wage base.

NOTE: It is important to emphasize that the 4.8 percent assumption was selected for simulation purposes only to demonstrate what would happen to the Unemployment Trust Fund if these legislative changes are enacted. The 4.8 percent assumption was used because it is the average of the insured unemployment rates for the past 10 years. No degree of probability should be attached to this assumption; it does not represent a forecast by the Commission.

SUMMARY OF RESULTS

Projected December 31 Fund Balance Under Each Proposal
1978-1982

Year	Current Law	Proposed Tax Schedule	Proposed Flexible Taxable Wage Base	Proposed Tax Schedules and Flexible Taxable Wage Base	Acceptable Fund Level
1978..........	$(-)13,200,000	$(-)12,900,000	$(-)13,200,000	$(-)12,900,000	$121,700,000
1979..........	(-) 5,700,000	11,600,000	(-) 2,600,000	13,100,000	133,100,000
1980..........	(-) 900,000	34,100,000	6,200,000	40,700,000	145,600,000
1981..........	400,000	52,600,000	15,600,000	69,600,000	159,200,000
1982..........	(-) 2,800,000	62,300,000	25,400,000	93,900,000	174,000,000

NOTE: All estimates are based on the assumption that the insured unemployment rate will be 4.8 percent for each year of the 1978-1982 period. The actual Fund balance at the end of each year would be higher by the amount of loans outstanding at that period.

CURRENT EMPLOYMENT SECURITY LAW

These projections of the Fund balance assume that no changes are made to the existing law. Under this condition, the taxable wage base would be $6,000 and the average employer tax rate is projected to remain at 3.3 percent throughout the period. The year-end Fund balances under the current law would generally remain in a deficit status.

PROPOSED TAX SCHEDULES:

With the proposed tax schedules in effect, the average employer tax rate would jump from 3.3 percent in 1978 to 4.3 percent in 1979, and then taper off to 4.0 percent by 1982. The taxable wage base would be $6,000. The Fund balance would recover quickly under this condition and grow to $62.3 million by the end of 1982.

PROPOSED FLEXIBLE TAXABLE WAGE BASE:

The taxable wage base proposed depends on average wages and, therefore, would change each year. During 1978 the taxable wage base would be $6,000, unchanged from current law. During 1979-1982 the base would increase as follows: 1979--$6,200; 1980--$6,600; 1981--$7,100; 1982--$7,600. The year-end Fund balances would rise steadily under this proposal and reach $25.4 million by 1982.

The revised tax schedules generate large amounts of additional income during the first few years after enactment which results in improved Fund balances. These increases in the Fund balances will cause a more favorable tax schedule to become effective beginning July 1, 1981, thus reducing the employer tax rate.

Under the proposed flexible taxable wage base, the taxable wage base will continue to increase as wages increase and thereby keep the ratio of taxable wages relatively constant. This is important since benefit payments are based on total wages, whereas contributions received are related to taxable wages. It is actuarially unsound to levy taxes on a wage base that does not keep pace with rising total wage levels.

PROPOSED TAX SCHEDULES AND FLEXIBLE TAXABLE WAGE BASE:

Under this proposal, the taxable wage base would increase from $6,000 in 1978 to $7,600 in 1982. The average employer tax rate would move from 3.3 percent in 1978 to 4.3 percent in 1979 and 1980. After 1980 the average employer tax rate would drop as a result of increases in reserves. The Fund balance at the end of each year would be the greatest under this proposal and reach $93.9 million by the end of 1982.

ACCEPTABLE FUND LEVEL:

The acceptable Fund level is based on the "one and one-half multiple" concept developed by the Federal government. This concept is described in detail within this report.

Although the projected Fund balance under each of the proposals is greatly above that occurring under current law, these levels are still below that which is acceptable. At the end of 1982, the Fund balance is projected to be $(-)2.8 million assuming no changes are made to the current law. If the current law is amended to incorporate both the flexible taxable wage base and the revised tax schedules, the Fund balance at the end of 1982 would be $93.9 million. This balance is still considerably below the acceptable level of $174.0 million as recommended by the Federal government.

DETAILED PROPOSALS AND PROJECTED IMPACT

PROJECTED FINANCIAL DATA UNDER CURRENT LAW, 1978-1982

Before the previously mentioned proposals are detailed, it is important to first examine projections assuming that the insured unemployment rate will be 4.8 percent for 1978 and each year through 1982, and the current law will not be amended throughout the period. The following table shows Regular and Extended Benefit cost, employer contributions received, and the Fund balance at the end of each year. Also, the taxable wage base and estimated employer tax rates are listed.

Year	Projected Financial Data (in thousands)			Taxable Wage Base	Average Employer Tax Rate
	Benefits Paid 1/	Contributions Received	Fund-Balance (Year-End) 2/		
1978........	$43,900	$51,100	$(-)13,200	$6,000	3.3%
1979........	48,400	55,900	(-) 5,700	6,000	3.3
1980........	53,100	57,900	(-) 900	6,000	3.3
1981........	58,300	59,600	400	6,000	3.3
1982........	64,800	60,800	(-) 2,800	6,000	3.3

1/ Benefits Paid includes Regular Benefits and State-share of Extended Benefits.

2/ The actual Fund balance at the end of each year would be higher by the amount of loans outstanding at that period.

PROJECTED FINANCIAL DATA UNDER PROPOSED TAX SCHEDULES, 1978-1982

The projections that follow in this section are based on the proposed tax schedules found below. These proposed tax schedules raise the maximum tax rate from 5.0 percent to 6.0 percent while reducing the number of schedules from 16 to 11. The schedule associated with reserve multiples of over 2.50 remains the same as the current law. Schedules associated with reserve multiples of 2.50 or less increase by 0.3 percent rather than 0.1 percent as in the current law.

Proposed Tax Schedules
Employer's Contribution Rate in Percent of Wages

Employer Reserve Ratio: Equal to or more than	Employer Reserve Ratio: Less than	When Reserve Multiple is: Over 2.50	2.27-2.50	2.04-2.26	1.82-2.03	1.59-1.81	1.36-1.58	1.13-1.35	.91-1.12	.68-.90	.45-.67	Under .45
Column A		Schedules: A	B	C	D	E	F	G	H	I	J	K
19.0% and over		.5%	.7%	1.0%	1.3%	1.6%	1.9%	2.2%	2.5%	2.8%	3.1%	3.4%
18.0%	19.0%	.6%	.8%	1.1%	1.4%	1.7%	2.0%	2.3%	2.6%	2.9%	3.2%	3.5%
17.0%	18.0%	.7%	.9%	1.2%	1.5%	1.8%	2.1%	2.4%	2.7%	3.0%	3.3%	3.6%
16.0%	17.0%	.8%	1.0%	1.3%	1.6%	1.9%	2.2%	2.5%	2.8%	3.1%	3.4%	3.7%
15.0%	16.0%	.9%	1.1%	1.4%	1.7%	2.0%	2.3%	2.6%	2.9%	3.2%	3.5%	3.8%
14.0%	15.0%	1.0%	1.2%	1.5%	1.8%	2.1%	2.4%	2.7%	3.0%	3.3%	3.6%	3.9%
13.0%	14.0%	1.1%	1.3%	1.6%	1.9%	2.2%	2.5%	2.8%	3.1%	3.4%	3.7%	4.0%
12.0%	13.0%	1.2%	1.4%	1.7%	2.0%	2.3%	2.6%	2.9%	3.2%	3.5%	3.8%	4.1%
11.0%	12.0%	1.3%	1.5%	1.8%	2.1%	2.4%	2.7%	3.0%	3.3%	3.6%	3.9%	4.2%
10.0%	11.0%	1.4%	1.6%	1.9%	2.2%	2.5%	2.8%	3.1%	3.4%	3.7%	4.0%	4.3%
9.0%	10.0%	1.5%	1.7%	2.0%	2.3%	2.6%	2.9%	3.2%	3.5%	3.8%	4.1%	4.4%
8.0%	9.0%	1.6%	1.8%	2.1%	2.4%	2.7%	3.0%	3.3%	3.6%	3.9%	4.2%	4.5%
7.0%	8.0%	1.7%	1.9%	2.2%	2.5%	2.8%	3.1%	3.4%	3.7%	4.0%	4.3%	4.6%
6.0%	7.0%	1.8%	2.0%	2.3%	2.6%	2.9%	3.2%	3.5%	3.8%	4.1%	4.4%	4.7%
5.0%	6.0%	1.9%	2.1%	2.4%	2.7%	3.0%	3.3%	3.6%	3.9%	4.2%	4.5%	4.8%
4.0%	5.0%	2.0%	2.2%	2.5%	2.8%	3.1%	3.4%	3.7%	4.0%	4.3%	4.6%	4.9%
3.0%	4.0%	2.2%	2.4%	2.7%	3.0%	3.3%	3.6%	3.9%	4.2%	4.5%	4.8%	5.1%
2.0%	3.0%	2.4%	2.6%	2.9%	3.2%	3.5%	3.8%	4.1%	4.4%	4.7%	5.0%	5.3%
1.0%	2.0%	2.6%	2.8%	3.1%	3.4%	3.7%	4.0%	4.3%	4.6%	4.9%	5.2%	5.5%
0.0%	1.0%	2.8%	3.0%	3.3%	3.6%	3.9%	4.2%	4.5%	4.8%	5.1%	5.4%	5.7%
Negative balance		3.1%	3.3%	3.6%	3.9%	4.2%	4.5%	4.8%	5.1%	5.4%	5.7%	6.0%

The highest tax rate proposed for Maine is 6.0 percent; Michigan (7.5%), Minnesota (7.5%), and New Jersey (6.2%) have higher tax rates. Connecticut, Iowa, and Vermont each have rates equal to 6.0 percent.

The projected financial information below assumes that the proposed tax schedules become effective July 1, 1978.

Year	Financial Data Under Proposal (in thousands)			Taxable Wage Base	Average Employer Tax Rate	Employer Contributions (in thousands)		
	Benefits Paid 1/	Contributions Received	Fund Balance (Year-End) 2/			Received Under Proposal	Received Under Current Law	Additional Income
1978..	$43,900	$51,400	$(-)12,900	$6,000	3.3%	$51,400	$51,100	$ 300
1979..	48,400	72,900	11,600	6,000	4.3	72,900	55,900	17,000
1980..	53,100	75,600	34,100	6,000	4.3	75,600	57,900	17,700
1981..	58,300	76,800	52,600	6,000	4.2	76,800	59,600	17,200
1982..	64,000	73,700	62,300	6,000	4.0	73,700	60,800	12,900

1/ Benefits Paid includes Regular Benefits and State-share of Extended Benefits.
2/ The actual Fund balance at the end of each year would be higher by the amount of loans outstanding at that period.

Note that under the proposed tax schedules, the Fund balance at the end of 1982 is estimated to be $62.3 million as compared to an estimated 1982 Fund balance of $(-)2.8 million if no legislative changes are made.

As a test of the acceptability of these proposed tax schedules, had these schedules and a reserve multiple system been in effect since 1965, it is estimated that on May 31, 1977, the Unemployment Trust Fund would have been $30.1 million. The tax schedules presently being used became effective in 1972. Had they been in effect since 1965, the estimated balance on May 31, 1977, would have been $(-)3.4 million.

The following table shows the actual May 31 Fund balance for each year from 1966-1977. For comparison purposes, estimates of the May 31 Fund balance are provided assuming the proposed tax schedules and the tax schedules currently in the law were in effect beginning July 1, 1965. Note that had the present tax schedules been in effect since July 1, 1965, the May 31 Fund balance in 1977 would be $(-)3.4 million rather than $(-)15.6 million, or an increase of $12.2 million. The proposed tax schedules, had they been in effect since July 1, 1965, would have increased the actual May 31 Fund balance by $45.7 million, a net positive balance of $30.1 million. It should be noted that the May 31 balance is provided since the balance on this date is used in determining the reserve multiple.

Actual and Estimated May 31 Fund Balance
Under Various Conditions, 1966-1977

Year	May 31 Fund Balance 1/		
	Actual	Present 2/ Schedules	Proposed 3/ Schedules
1966......................	$ 37,036,971	$ 42,500,000	$ 46,900,000
1967......................	40,009,726	50,000,000	57,700,000
1968......................	42,295,448	57,600,000	64,600,000
1969......................	43,800,013	62,700,000	68,400,000
1970......................	42,244,490	64,800,000	71,300,000
1971......................	30,058,839	56,200,000	63,300,000
1972......................	16,861,099	42,300,000	50,300,000
1973......................	22,440,977	45,700,000	58,000,000
1974......................	27,917,746	50,300,000	69,500,000
1975......................	10,299,843	30,300,000	53,900,000
1976......................	(-) 3,816,906	11,900,000	39,000,000
1977......................	(-)15,629,649	(-) 3,400,000	30,100,000

1/ The actual Fund balance at the end of each year would be higher by the amount of loans outstanding at that period.

2/ Assumes that the reserve multiple system currently law became effective July 1, 1965.

3/ Assumes that the proposed schedules and the reserve multiple system became effective July 1, 1965.

PROJECTED FINANCIAL DATA UNDER PROPOSED FLEXIBLE TAXABLE WAGE BASE, 1978-1982

The projections presented in this section are based on the proposed flexible taxable wage base as described below. For each year beginning with 1978, the flexible taxable wage base would equal the larger of:

1. two-thirds the average annual wage paid in covered employment during the second preceding calendar year and rounded to the nearest $100; or

2. the Federal Unemployment Tax Act (FUTA) taxable wage base.

As an example, the calculation of the tax base that would be in effect during the year beginning January 1, 1978, is as follows:

The average annual wage paid	
in covered employment during	$8,604
the second preceding calendar year (1976)	x
multiplied by 2/3	2/3
equals	= $5,736
rounded to the nearest $100	= $5,700

The taxable wage base effective January 1, 1978, would be the larger of either $5,700, or the FUTA taxable wage base. In this case, the FUTA taxable wage base equals $6,000; therefore, the taxable wage base to become effective in 1978 in Maine would be $6,000.

For comparison, as of January 1978, four states (Hawaii, North Dakota, Utah, and Washington) had flexible taxable wage bases resulting from a variety of formulas that relate to either previous wages, Fund balance, or benefit cost.

Alaska has the highest taxable wage base of $10,000, while six other states (Idaho, Iowa, Minnesota, Nevada, New Jersey, and Oregon) have taxable wage bases above $6,000.

During the projection period, the proposed flexible taxable wage base increases from $6,000 in 1978 to $7,600 in 1982. Under current law, this base would remain constant at $6,000. The total amount of additional employer contributions during this period is projected to be more than $28 million. These additional contributions are projected to raise the Fund balance from $(-)2.8 million under current law to $25.4 million under the proposed flexible wage base.

The projected information below assumes that the flexible taxable wage base proposal becomes effective January 1, 1978.

Year	Financial Data Under Proposal (in thousands) Benefits Paid 1/	Contributions Received	Fund Balance (Year-End) 2/	Taxable Wage Base	Average Employer Tax Rate	Employer Contributions (in thousands) Received Under Proposal	Received Under Current Law	Additional Income
1978..	$43,900	$51,100	$(-)13,200	$6,000	3.3%	$51,100	$51,100	0
1979..	48,400	59,000	(-) 2,600	6,200	3.3	59,000	55,900	$3,100
1980..	53,100	61,900	6,200	6,600	3.3	61,900	57,900	4,000
1981..	58,300	67,700	15,600	7,100	3.3	67,700	59,600	8,100
1982..	64,000	73,800	25,400	7,600	3.3	73,800	60,800	13,000

1/ Benefits Paid includes Regular Benefits and State-share of Extended Benefits.

2/ The actual Fund balance at the end of each year would be higher by the amount of loans outstanding at that period.

The Fund balance at the end of 1982 is projected to be $25.4 million under the flexible taxable wage base proposal. This Fund balance is considerably less than the $62.3 million projection which was obtained from the revised tax schedules.

Had the flexible taxable wage base and the currently effective tax schedules been in the law beginning in 1965, the Unemployment Trust Fund balance on May 31, 1977, would have been $3.8 million. This represents an estimated increase of over $19.4 million when compared to the actual May 31, 1977, Fund balance of $(-)15.6 million.

The following table lists the actual May 31 Fund balance and the actual taxable wage base in effect. This table also shows the effect the present tax schedules would have on the Fund compared with the present tax schedule and a flexible taxable wage base.

Taxable Wage Base, Actual and Estimated May 31 Fund
Balance Under Various Conditions, 1966-1977

Year	Taxable Wage Base	May 31 Fund Balance (000's) 1/		Proposed Flexible Taxable Wage Base 2/	
		Actual	Present 3/	Taxable Wage Base	May 31 Fund Balance (000's) 3/
1966....	$3,000	$ 37,037	$ 42,500	$3,000	$42,500
1967....	3,000	40,010	50,000	3,100	51,300
1968....	3,000	42,295	57,600	3,200	57,900
1969....	3,000	43,800	62,700	3,400	63,300
1970....	3,000	42,244	64,800	3,600	66,300
1971....	3,000	30,059	56,200	3,800	59,700
1972....	4,200	16,861	42,300	4,200	45,000
1973....	4,200	22,441	45,700	4,200	48,400
1974....	4,200	27,918	50,300	4,300	53,100
1975....	4,200	10,300	30,300	4,600	34,100
1976....	4,200	(-) 3,817	11,900	4,900	14,500
1977....	4,200	(-)15,630	(-) 3,400	5,300	3,800

1/ Assumes the present tax schedules and reserve multiple concept were law in 1965.

2/ Assumes the present tax schedules, reserve multiple concept, and the flexible taxable wage base were in effect beginning in 1965.

3/ The actual Fund balance at the end of each year would be higher by the amount of loans outstanding at that period.

PROJECTED FINANCIAL DATA UNDER PROPOSED TAX SCHEDULES AND FLEXIBLE WAGE BASE, 1978-1982

If both the flexible taxable wage base and the proposed tax schedules had been enacted to become effective in 1978, it is projected that the Unemployment Trust Fund balance at the end of 1982 would increase from $(-)2.8 million under the current law to $93.9 million.

The following financial information is based on the assumption that the flexible taxable wage base became effective January 1, 1978, and that the proposed tax schedules will become effective July 1, 1978.

Year	Financial Data Under Proposal (in thousands)			Taxable Wage Base	Average Employer Tax Rate	Employer Contributions (in thousands)		
	Benefits Paid 1/	Contributions Received	Fund Balance (Year-End) 2/			Received Under Proposal	Received Under Current Law	Additional Income
1978..	$43,900	$51,400	$(-)12,900	$6,000	3.3%	$51,400	$51,100	$ 300
1979..	48,400	74,400	13,100	6,200	4.3	74,400	55,900	18,500
1980..	53,100	80,700	40,700	6,600	4.3	80,700	57,900	22,800
1981..	58,300	87,200	69,600	7,100	4.2	87,200	59,600	27,700
1982..	64,000	88,300	93,900	7,600	3.9	88,300	60,800	27,500

1/ Benefits Paid includes Regular Benefits and State-share of Extended Benefits.

2/ The actual Fund balance at the end of each year would be higher by the amount of loans outstanding at that period.

ADEQUATE FUND LEVEL MEASUREMENT

ADEQUATE FUND LEVEL MEASUREMENT UNDER VARIOUS CONDITIONS

The "one and one-half multiple" concept discussed below was developed by the U.S. Department of Labor. The concept of reserve ratio and reserve multiple is similar to that found in the Maine Employment Security Law but differs slightly in definition of terms.

Fund balances are usually analyzed in terms of their ability to meet potential benefit costs. To measure adequacy, the U.S. Department of Labor has developed a "one and one-half multiple" concept. This concept relates a state's Fund reserve ratio to its benefit cost rate. A Fund reserve ratio is defined as the end-of-year Fund balance as a percent of total wages of contributing employers for that year. The benefit cost rate is obtained by expressing Regular and State-share of Extended Benefits paid (excluding direct reimbursable payments) as a percentage of total wages from contributing employers for the same period. The actual multiple is then determined by dividing the Fund reserve ratio by the benefit cost rate. When first adopted in 1959, the multiple was based on the highest 12-month benefit cost rate during the past 10 years; however, as low unemployment costs continued through the 1960s, and it appeared that the last 10 years would contain no significantly high cost rates in most states, the time frame was changed to that beginning in 1958. While proposed as a minimum level, this measure has been accepted as a "level of safety." This means that a state's Fund balance is considered to be at a safe level if the actual multiple for that year is greater than 1.5, that is, the Fund reserve ratio is one and one-half times the highest 12-month benefit cost rate since 1958.

The following illustrates the process of determining Maine's actual multiple for Calendar Year 1976:

$$\text{Fund Reserve Ratio} = \frac{\text{End-of-Year Fund Balance}}{\text{Total Wages for Year}}; \text{ for 1976} = \frac{\$(-)7{,}694{,}855}{\$2{,}384{,}764{,}762} = (-).32\%$$

Highest 12-month Benefit Cost Rate since 1958 was Calendar Year 1975.

$$\text{Benefit Cost Rate} = \frac{\text{Benefits Paid}}{\text{Total Wages}} \text{ for 1975} = \frac{\$\ 58{,}330{,}903}{\$2{,}055{,}161{,}391} = 2.84\%$$

$$\text{Actual Multiple} = \frac{\text{Fund Reserve Ratio}}{\text{Highest 12-month Benefit Cost Rate}}; \text{ for 1976} = \frac{(-).32\%}{2.84\%} = (-).11$$

Therefore, the actual multiple for 1976 was (-).11, which is considerably below the prescribed safety level of 1.5. In order to be considered at a safe level, the end-of-year Fund balance for 1976 would have had to equal $101.6 million.

The remainder of this section contains an analysis of the adequacy of the Fund balances estimated for each of the proposed legislative changes. The estimated Fund balances are compared to the acceptable level as measured in terms of the one and one-half multiple concept.

Fund Level Measurement, 1970-1977:

The following table shows the highest cost rate that has occurred since 1958, the Fund reserve ratio calculated as of December 31, the actual and acceptable multiple, and the actual and acceptable Fund balance for years from 1970 through 1977.

Year	Highest Cost Rate	Fund Reserve Ratio	Multiple		Fund Balance* (in millions)	
			Actual	Acceptable	Actual	Acceptable
1970.....	2.83% 1/	2.84%	1.00	1.50	$ 38.4	$ 57.5
1971.....	2.83	1.51	.53	1.50	21.2	59.3
1972.....	2.83	1.26	.45	1.50	21.0	70.9
1973.....	2.83	1.56	.55	1.50	28.5	77.5
1974.....	2.83	1.45	.51	1.50	28.8	84.1
1975.....	2.83	.07	.02	1.50	1.4	87.2
1976.....	2.84 2/	(-).32	(-).11	1.50	(-)7.7	101.6
1977 3/..	2.84	(-).79	(-).28	1.50	(-)20.4	110.7

* The actual Fund balance at the end of each year would be higher by the amount of loans outstanding at that period.

1/ Cost rate for the 12-month period ending September 1958.
2/ Beginning in 1976 the highest cost rate in effect is the cost rate for calendar year 1975.
3/ Estimated data.

Note that the actual multiple has declined steadily from 1.00 in 1970 to (-).28 in 1977. The atypically high unemployment that the State experienced beginning in late 1974 and extending to the present period caused an already weak Fund to default completely.

Fund Level Measurement, 1978-1982:

The following table shows that the actual multiple will increase slightly until 1982 when it drops to (-).02, assuming no legislative changes are made to the current law. During the entire period, the actual multiple is greatly below the acceptable multiple. The Fund balance at the end of the projected period is $(-)2.8 million while the acceptable level is $174.0 million.

Year	Highest Cost Rate	Fund Reserve Ratio	Multiple		Fund Balance* (in millions)	
			Actual	Acceptable	Actual	Acceptable
1978.....	2.84%	(-).46%	(-).16	1.50	$(-)13.2	$121.7
1979.....	2.84	(-).18	(-).06	1.50	(-) 5.7	133.1
1980.....	2.84	(-).03	(-).01	1.50	(-) .9	145.6
1981.....	2.84	.01	0	1.50	.4	159.2
1982.....	2.84	(-).07	(-).02	1.50	(-) 2.8	174.0

* The actual Fund balance at the end of each year would be higher by the amount of loans outstanding at that period.

Fund Level Measurement Under Proposed Tax Schedules, 1978-1982:

If the proposed tax schedules are enacted to become effective July 1, 1978, significant improvements in the actual multiple will be realized. The multiple increases from (-).16 in 1978 to .54 in 1982. The gap between the actual and acceptable Fund balance in 1982 is reduced from $176.8 million under current law to $111.7 million assuming this proposal is enacted.

Year	Highest Cost Rate	Fund Reserve Ratio	Multiple		Fund Balance* (in millions)	
			Actual	Acceptable	Actual	Acceptable
1978.....	2.84%	(-).45%	(-).16	1.50	$(-)12.9	$121.7
1979.....	2.84	.37	.13	1.50	11.6	133.1
1980.....	2.84	1.00	.35	1.50	34.1	145.6
1981.....	2.84	1.41	.50	1.50	52.6	159.2
1982.....	2.84	1.53	.54	1.50	62.3	174.0

* The actual Fund balance at the end of each year would be higher by the amount of loans outstanding at that period.

Fund Level Measurement Under Proposed Flexible Wage Base, 1978-1982:

The proposed flexible taxable wage base would create improvements in the Fund, but not to the degree of the proposed tax schedules. As stated in the Summary of Results, the long-term effects of the flexible taxable wage base remain relatively constant, while the impact of the revised tax schedules appears to lessen over time as Fund balances improve. The actual Fund balance under the flexible taxable wage base proposal is estimated to be $28.2 million more than under current law. The difference between the actual and acceptable Fund level is $148.6 million as compared to $176.8 million under current law.

Year	Highest Cost Rate	Fund Reserve Ratio	Multiple		Fund Balance* (in millions)	
			Actual	Acceptable	Actual	Acceptable
1978......	2.84%	(-).46%	(-).16	1.50	$(-)13.2	$121.7
1979......	2.84	(-).08	(-).03	1.50	(-) 2.6	133.1
1980......	2.84	.18	.06	1.50	6.2	145.6
1981......	2.84	.42	.14	1.50	15.6	159.2
1982......	2.84	.62	.22	1.50	25.4	174.0

* The actual Fund balance at the end of each year would be higher by the amount of loans outstanding at that period.

Fund Level Measurement Under Proposed Tax Schedules and Flexible Wage Base, 1978-1982:

As would be expected, the greatest improvement in terms of multiple and Fund levels occurs when both the flexible taxable wage base and the proposed tax schedules are enacted. The actual multiple increases from (-).16 in 1978 to .81 in 1982. The gap between the actual and acceptable Fund balance decreases from $176.8 million under current law to $80.1 million when these two proposals are in effect.

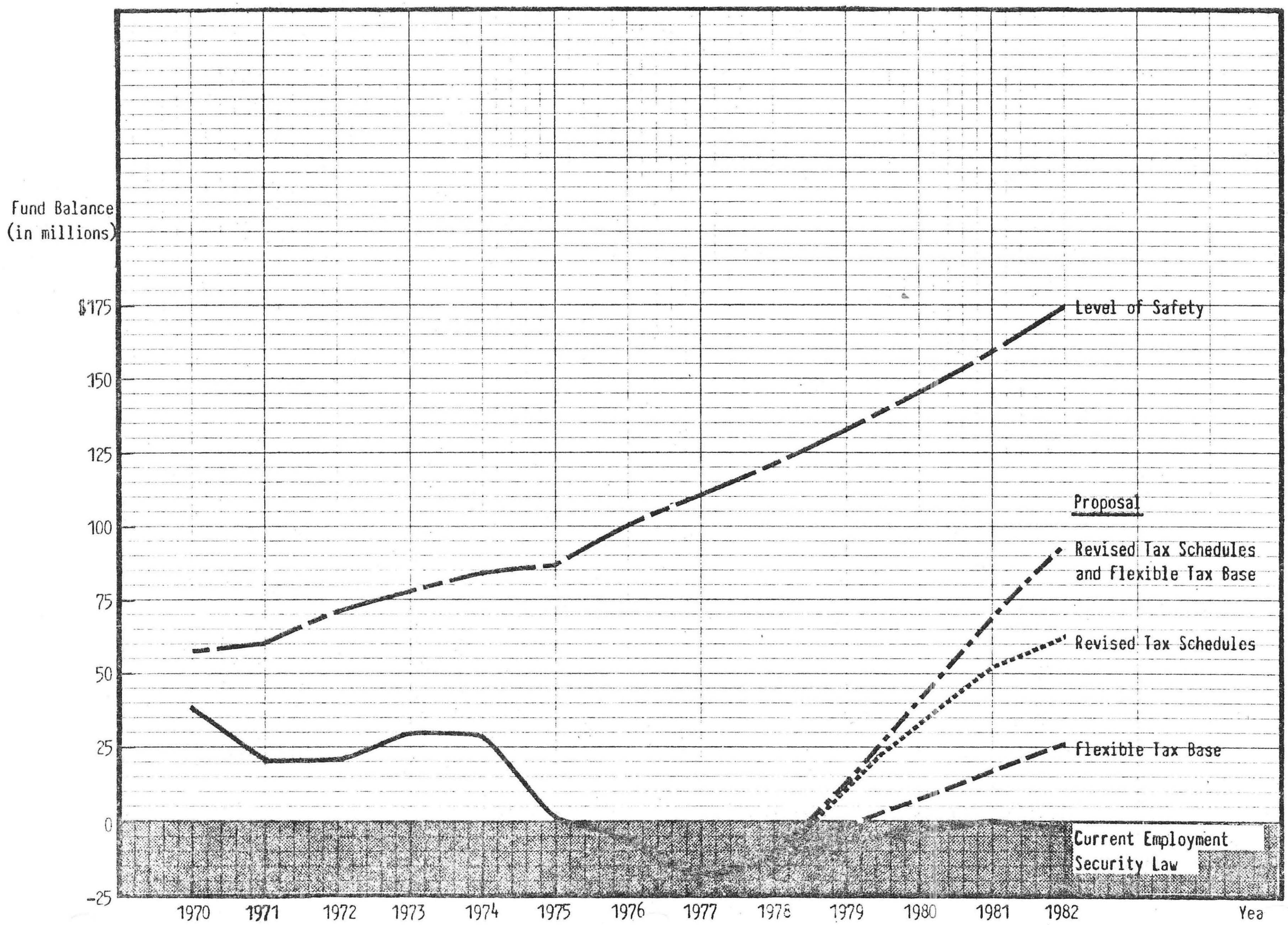
Year	Highest Cost Rate	Fund Reserve Ratio	Multiple		Fund Balance* (in millions)	
			Actual	Acceptable	Actual	Acceptable
1978......	2.84%	(-).45%	(-).16	1.50	$(-)12.9	$121.7
1979......	2.84	.42	.15	1.50	13.1	133.1
1980......	2.84	1.19	.42	1.50	40.7	145.6
1981......	2.84	1.86	.65	1.50	69.6	159.2
1982......	2.84	2.30	.81	1.50	93.9	174.0

* The actual Fund balance at the end of each year would be higher by the amount of loans outstanding at that period.

GRAPHS

Graph 1

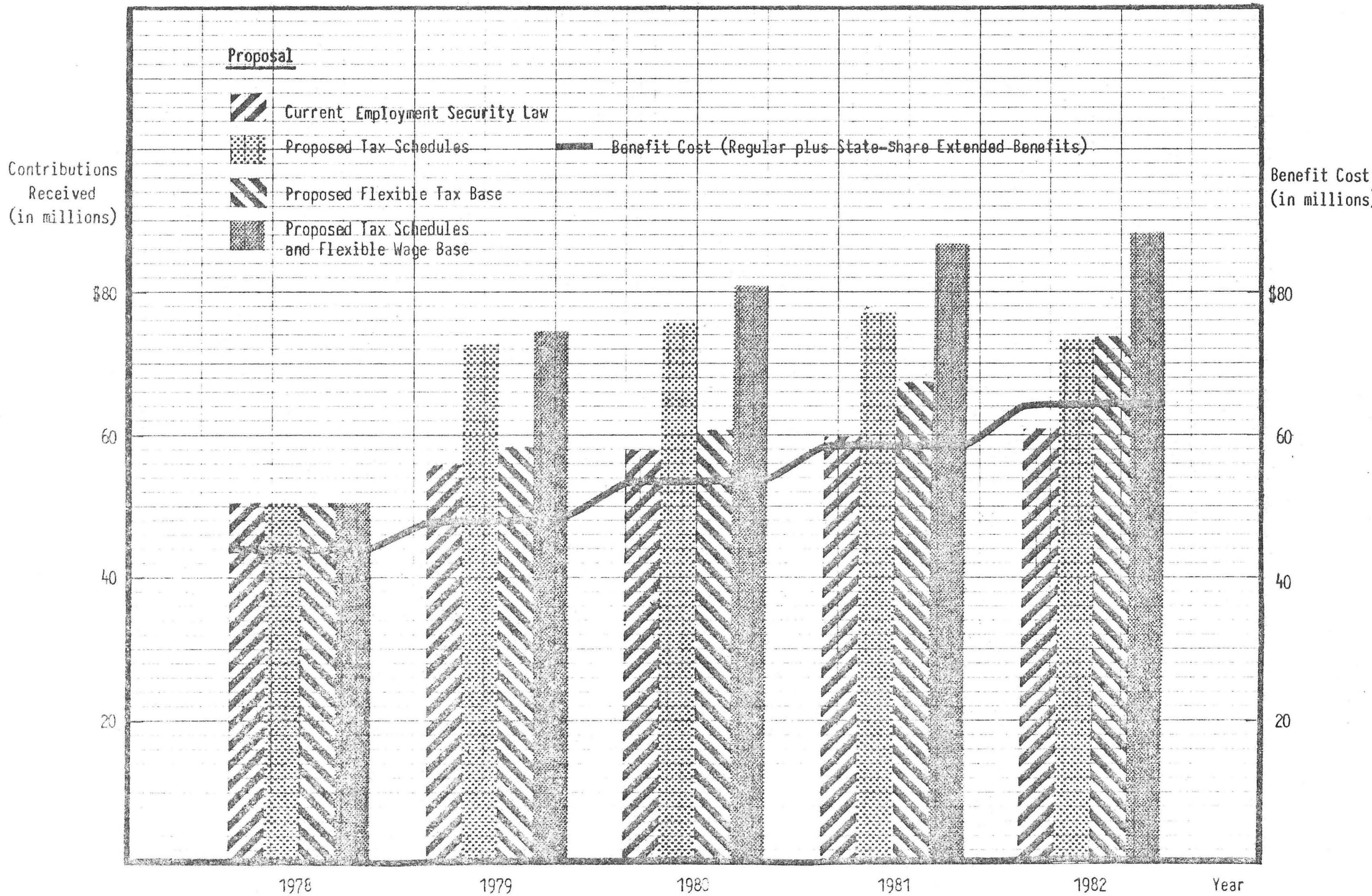
PROJECTED LEVEL OF SAFETY AND YEAR-END FUND BALANCE UNDER EACH PROPOSAL
1970-1982*



*Actual data through 1977

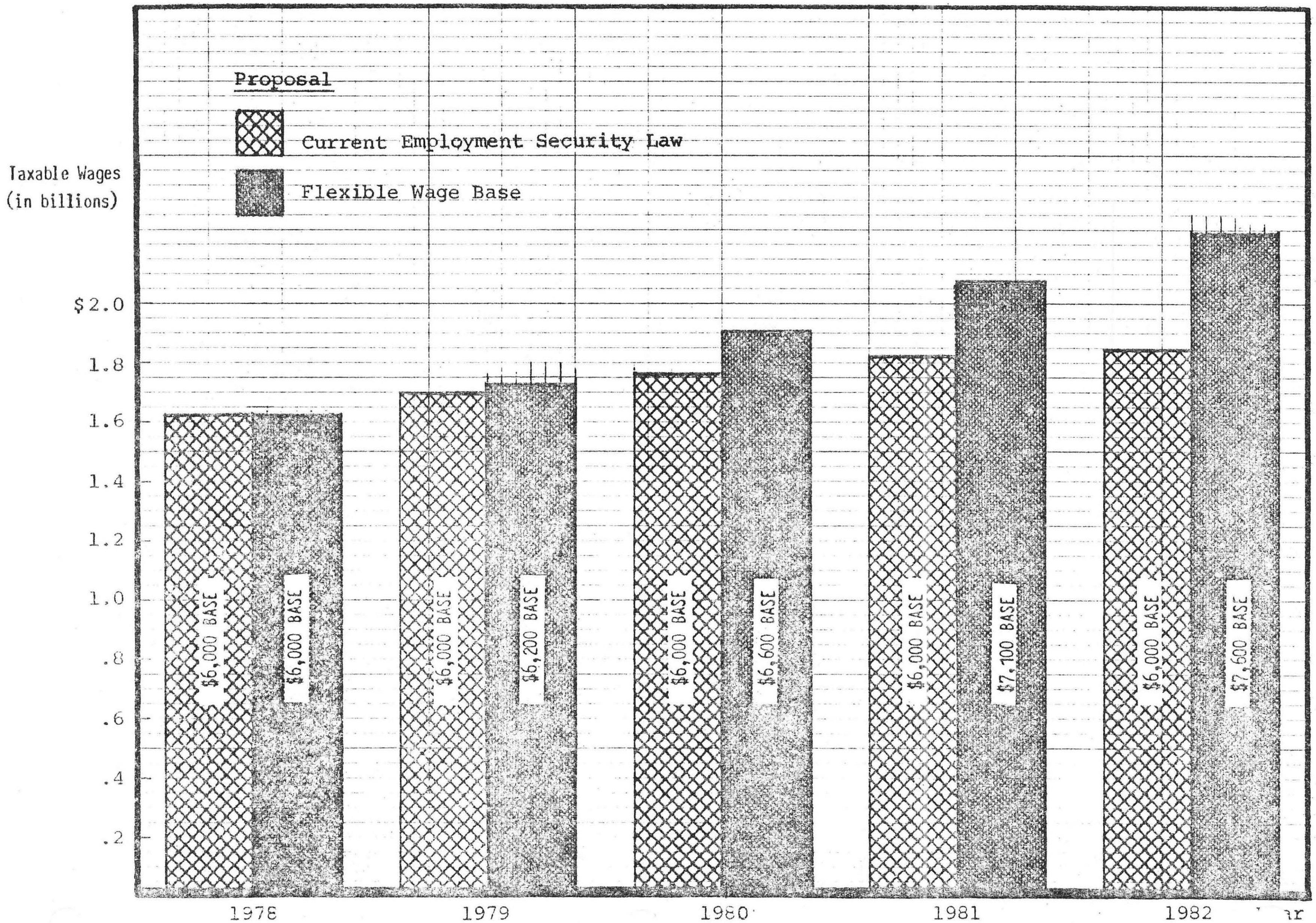
Graph 2

PROJECTED BENEFIT COST AND CONTRIBUTIONS RECEIVED
UNDER EACH PROPOSAL, 1978-1982



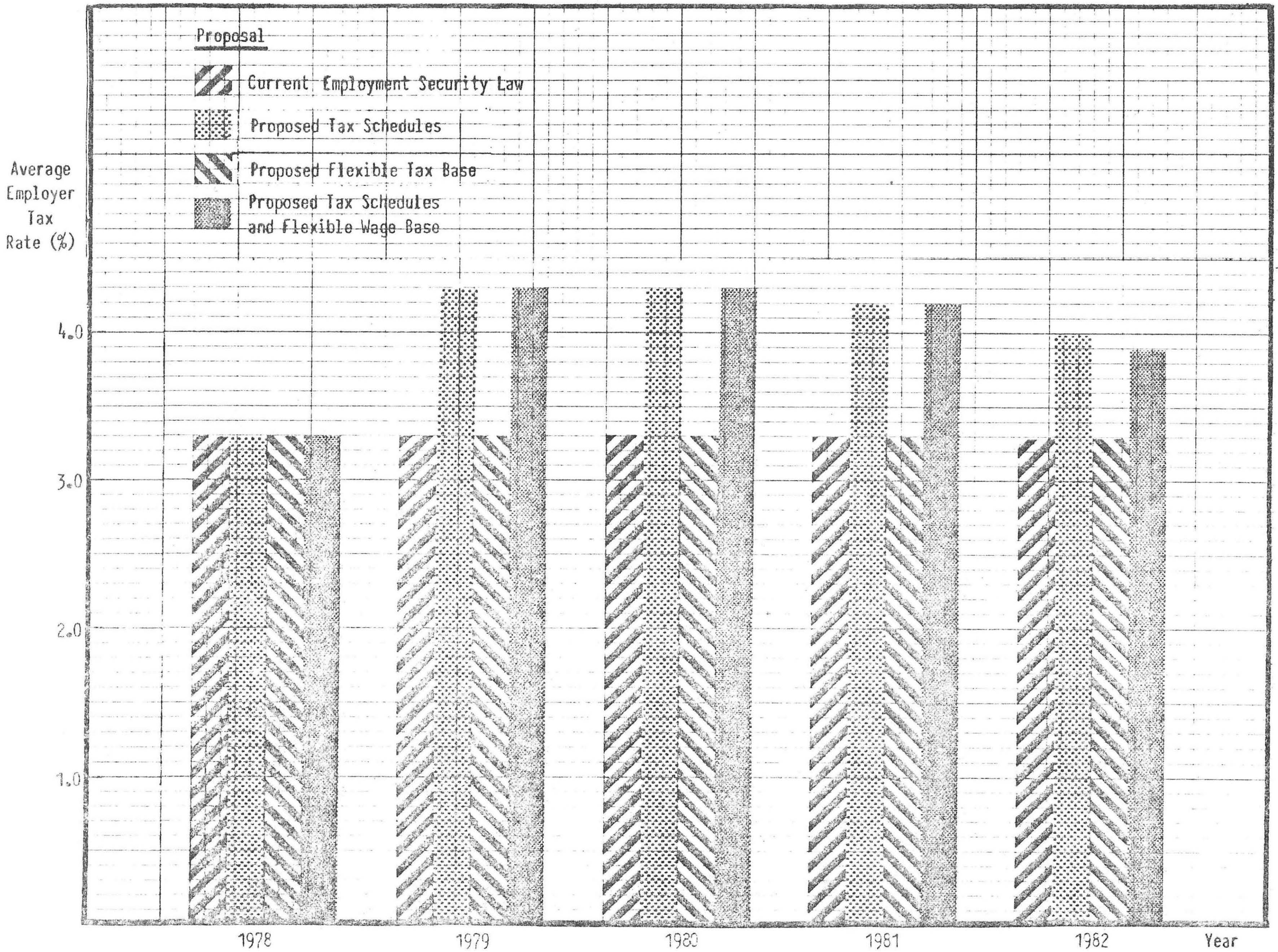
Graph 3

PROJECTED TAXABLE WAGES UNDER CURRENT EMPLOYMENT SECURITY LAW AND FLEXIBLE TAXABLE WAGE BASE, 1978-1982



Graph 4

PROJECTED AVERAGE EMPLOYER TAX RATE UNDER EACH PROPOSAL, 1978-1982



APPENDIX B

STATEMENT OF ASSOCIATED INDUSTRIES CONCERNING
THE FUNDING OF UNEMPLOYMENT COMPENSATION

In accordance with the request of the Joint Committee on Labor for comments concerning the funding of unemployment insurance, the following is submitted as a statement of Associated Industries' position on this issue.

Associated Industries of Maine concurs in the judgment of the Committee that funding recommendations should be deferred in order to give the 109th Legislature an opportunity to undertake a comprehensive study of the funding question. In fact, there are two distinct questions: the short-range question of whether Maine will be able to repay its outstanding debt to the federal government without incurring penalties on Maine employers and the long-range question of whether Maine will be able to maintain its unemployment compensation program without incurring an inordinate amount of Federal indebtedness in the future.

As to the short-range question, it is the opinion of AIM, based on information currently available from the Manpower Research Division, that Maine will qualify for deferral of its loan payment obligation in 1979 and will be able to repay the loan prior to the deadline of November 10, 1980 without incurring penalties.

Under regulations promulgated by the Secretary of Labor, a state will qualify for deferral in 1979 if its 1979 average employer tax rate for that year exceeds the previous 10-year average benefit cost rate. The most recent estimates provided by the Research Division project a 1.80% average employer tax rate for 1979 and a 1.77% cost rate for the 10-year period ending in 1978. In addition, the department has projected that the 1.80% tax rate will remain unchanged even if a substantial increase in the unemployment rate occurs. (See attached copy) There can be little doubt, therefore, that the state will qualify for deferral in 1979. As to the question of Maine's ability to repay the loan before the deadline, postponement in making recommendations will give the 109th Legislature an opportunity to evaluate the situation in light of possible Federal legislation which may signi-

ficantly ameliorate the problem. First, the National Commission on Unemployment Compensation, which was established by the 95th Congress to study various unemployment insurance problems, is likely to recommend legislation providing for reimbursement of states, from general revenues, of their 50% share of extended benefit costs incurred during the period from January 1, 1975 to January 1, 1978. It is estimated that the State of Maine would receive nearly $16,000,000 under this proposal. Secondly, it is likely that the 96th Congress will give serious consideration to various "cost equalization" bills which were originally introduced in 1977. In effect, these proposals would relieve states which are indebted to the Federal Government from repayment of all or part of advances from the federal fund.

Even if Congress takes no affirmative action on these proposals or recommendations in 1979, the prospects for timely repayment of the loan appear to be favorable. Under Federal law, the State's loans are not required to be repaid until November 10, 1980. Assuming, as the Research Division has, that the unemployment rate does not exceed 4.8% during this period, it is quite possible that the State will have developed a sufficient fund reserve to satisfy its indebtedness prior to the present deadline.

Consequently, contrary to several assertions made at the hearing on November 14, 1978, there is no immediate need to consider any of the proposals for tax increases outlined by the Department of Manpower Affairs.

As to the long-range questions, if further study is undertaken by the 109th Legislature, there appear to be three areas of primary concern: (1) Fund adequacy, (2) benefit costs and (3) equitable distribution of the tax burden. Thus far, the committee has no specific criteria, other than general federal guidelines, to utilize in evaluating the present or future adequacy of the fund. This concept of fund adequacy has not yet been fully explored or defined. It would seem to be imperative that specific guidelines be formulated which are realistic in the context of the State's economic situation and the ability of Maine employers to finance the

fund at given levels. With respect to benefit costs, it is readily apparent that the present condition of the fund is attributable not only to the high levels of unemployment experienced in 1975 but also to the progressive escalation of benefit levels under the State's Unemployment Compensation Law. Serious consideration, therefore, should be given to reducing the drain on the fund by establishing more stringent criteria for eligibility and disqualification of claimants, by re-evaluating the existing limitations on maximum benefits and by elimination of dependency benefits from the unemployment insurance scheme. If, on the other hand, the present benefit levels are to be maintained, or indeed increased, serious consideration should be given to alternate sources of funds, including contributions by employees and general fund appropriations to cover recently granted benefits outside the traditional areas of unemployment insurance.

In conclusion, as the short-range questions of deferral and loan repayment do not appear to warrant immediate legislative attention, it is submitted that it would be more appropriate to reserve the remaining long-range questions for intensive study by the 109th Legislature, with particular emphasis to be given to analysis of the concept of fund adequacy, benefit levels and equitable distribution of the tax burden.

MAINE DEPARTMENT OF MANPOWER AFFAIRS
Employment Security
Manpower Research Division

It is important to note that these projections were prepared on very short notice and should be considered as preliminary. Unless otherwise stated, all projections are based on an insured unemployment rate of 4.8 percent for each year and that the private labor force will increase by 1.8 percent for each year.

1. Deferral for 1979

Regular and State share of Extended Benefits attributable to taxable employers

Actual Data	January-October 1978	=	$38,229,373
Projected Data	November-December 1978	=	5,800,000
	Total for 1978	=	$44,029,373

Total wages paid by taxable employers

Actual Data	January-March 1978	=	$ 660,489,874
Projected Data	April-December 1978	=	2,275,010,126
	Total for 1978	=	$2,935,500,000

Year	Regular and State Share of Extended Benefits Attributable to Taxable Employers	Total Wages Paid by Taxable Employers
1969.........	$ 11,961,616	$ 1,275,320,978
1970.........	17,504,139	1,353,382,198
1971.........	29,042,640	1,398,107,706
1972.........	25,159,648	1,669,994,764
1973.........	21,997,473	1,824,739,786
1974.........	30,759,067	1,982,014,177
1975.........	58,330,903	2,055,161,391
1976.........	48,275,538	2,384,764,762
1977.........	56,790,147	2,566,063,965
1978 (Projected)	44,029,373	2,935,500,000
10-Year Total (Projected)	$343,850,544	$19,445,049,727

Projected 10-Year Annual Benefit Cost Rate = $\frac{\$\ 343,850,544}{\$19,445,049,727} = 1.77\%$

2. Projected average employer tax rate for 1979 at various insured unemployment rates

5.0% Insured Unemployment Rate

$$\frac{\$\ 56,100,000}{\$3,119,200,000} = 1.80\%$$

5.5% Insured Unemployment Rate

$$\frac{\$\ 55,800,000}{\$3,104,400,000} = 1.80\%$$

6.0% Insured Unemployment Rate

$$\frac{\$\ 55,600,000}{\$3,089,500,000} = 1.80\%$$

6.5% Insured Unemployment Rate

$$\frac{\$\ 55,300,000}{\$3,074,700,000} = 1.80\%$$

3. Projected Unemployment Compensation Fund Balance as of November 10, 1979

$36,000,000 (includes Federal loans of $36,400,000)

4. The administrative costs of operating the Unemployment Insurance Program are financed by the Federal Unemployment Tax Act (FUTA) portion of the employer's tax. The State portion of the employer's tax is not used to finance any administrative costs.

5. <u>Delinquent Contributions Receivable</u>, as shown on the Department's monthly Trial Balance, is cumulative from the beginning of the UI Program. This amount is <u>not included</u> in the Balance of the Unemployment Compensation Fund.

   Every effort is made to collect contributions from delinquent employers. After the Department collection procedures are pursued to the fullest, delinquent employers are referred to the Attorney General's Office for legal action. In those cases where legal action is unsuccessful, the Attorney General's Office recommends to the Commissioner of Finance and Administration that the cases be charged off. For 1978, 56 cases representing $20,670.65 have been recommended to the Finance Commissioner.

STATE OF MAINE

APPENDIX C

In House

Whereas, the State of Maine has had to borrow over $32,000,000 from the Federal Government to finance the payment of unemployment compensation benefits; and

Whereas, Maine employers will be required to pay back the federal loans; and

Whereas, there are questions concerning the fairness of the existing contribution and tax tables applied to Maine employers; and

Whereas, the future solvency of the State Unemployment Compensation Fund is crucial to the State's ability to repay the federal loans; now, therefore, be it

Ordered, the Senate concurring, that the Joint Standing Committee on Labor be authorized to study how the Employment Security Act and the State Unemployment Compensation Fund can more effectively and equitably protect the rights of all concerned parties; and be it further

Ordered, that sufficient funds shall be available to properly reproduce and distribute this study; and be it further

Ordered, that the Joint Standing Committee on Labor shall complete this study no later than December 1, 1978, and submit to the Legislative Council within the same time period its findings and recommendations, including copies of any recommended legislation in final draft form; and be it further

Ordered, upon passage in concurrence, that a suitable copy of this order shall be forwarded to members of the committee.

HP 2160

Name: (Lewis) Joan E. Lewis   Cosponsor: (Bustin) David W. Bustin

Town: Auburn   of Augusta

FORM O-85